No. 89-1283-CFX
Status: GRANTED

Title: Arcadia, Ohio, et al., Petitioners
v.
Ohio Power Company, et al.

Docketed:
February 9, 1990

Court: United States Court of Appeals for the District of Columbia Circuit

Counsel for petitioner: Ottinger,Gregg D., Phillips,Carter G.

Counsel for respondent: Berlin,Edward, Kauffelt,T. D., Solicitor General

NOTE: Petr shld be as above 010290 ext untl 020990 by CJ-CITED

Entry	Date	Note	Proceedings and Orders
1	Dec 28 1989	G	Application (A89-486) to extend the time to file a petition for a writ of certiorari from January 10, 1990 to February 9, 1990, submitted to The Chief Justice.
2	Jan 2 1990		Application (A89-486) granted by the Chief Justice extending the time to file until February 9, 1990.
3	Feb 9 1990	G	Petition for writ of certiorari filed.
4	Mar 1 1990		Brief of respondent United States filed.
5	Mar 1 1990		Brief amicus curiae of Indiana Municipal Power Agency filed.
6	Mar 5 1990		Brief of respondents LCP Chemicals, Inc., et al. in opposition filed.
7	Mar 7 1990		DISTRIBUTED. March 23, 1990
8	Mar 12 1990	X	Brief of respondent Ohio Power Company in opposition filed.
9	Mar 16 1990	X	Reply brief of petitioners Arcadia, OH, et al. filed.
10	Mar 26 1990		Petition GRANTED.
			**********
12	Apr 20 1990		Order extending time to file brief of petitioner on the merits until May 25, 1990.
13	May 25 1990		Brief of respondents LCP Chemicals, Inc., et al. in support of petition filed.
14	May 25 1990		Brief amicus curiae of American Public Power Assn., et al. filed.
15	May 25 1990		Joint appendix filed.
16	May 25 1990		Brief of petitioners Arcadia, OH, et al. filed.
17	May 25 1990		Brief of respondent FERC in support of of the petitioners and for the Securities Exchange Commission as amicus curiae filed.
18	May 25 1990		Brief amicus curiae of Indiana Municipal Power Agency filed.
19	Jun 11 1990	G	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
20	Jun 18 1990		Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
21	Jun 25 1990		Brief of respondent Ohio Power Company filed.
22	Jun 25 1990		Brief amicus curiae of Registered Holding Company Group filed.
23	Jul 2 1990		CIRCULATED.

No. 89-1283-CFX

Entry	Date	Note	Proceedings and Orders
24	Jul 9 1990	X	Reply brief of petitioner FERC filed.
25	Jul 12 1990	G	Application (A90-37) to extend the time to file a reply brief from July 25, 1990 to August 8, 1990, submitted t The Chief Justice.
26	Jul 16 1990		Application (A90-37) granted by the Chief Justice extending the time to file until August 8, 1990.
27	Jul 23 1990		SET FOR ARGUMENT MONDAY, OCTOBER 1, 1990. (1ST CASE)
28	Aug 8 1990	X	Reply brief of petitioners Arcadia, OH, et al. filed.
29	Sep 10 1990		Record filed.
		*	Certified copy of original record and proceedings received.
30	Oct 1 1990		ARGUED.

Supreme Court, U.S.
FILED
FEB 9 1990
JOSEPH F. SPANIOL, JR.
CLERK

89-1283

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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February 9, 1990

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission is entitled to judicial deference in interpreting Section 318 of the Federal Power Act (FPA), one of the Commission's own organic statutes, even though that particular section of the Act concerns the Commission's jurisdiction.

2. Whether Section 318 of the FPA should be interpreted to oust the Federal Energy Regulatory Commission of jurisdiction over rate matters only when there is an actual conflict between a requirement imposed by that agency pursuant to the FPA and a requirement imposed by the Securities and Exchange Commission pursuant to the Public Utility Holding Company Act.

PARTIES TO THE PROCEEDING

In addition to the petitioner listed in the caption, the following Ohio municipalities were parties in the court below and are petitioners herein:

Bloomdale
Bryan
Carey
Cygnet
Deshler
Greenwich
Ohio City
Plymouth
Republic
Shiloh
St. Clairsville
Sycamore
Wapakoneta
Wharton

In addition to the respondent listed in the caption, the following parties in the court below are respondents herein:

Federal Energy Regulatory Commission
LCP Chemicals, Inc.
Mobay Corporation
Olin Corporation
PPG Industries, Inc.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. ——

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners hereby petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-28a) is reported at 880 F.2d 1400 (D.C. Cir. 1989). The decision of the Federal Energy Regulatory Commission (FERC) (App., *infra*, 31a-67a) is reported at 39 F.E.R.C. ¶ 61,098 (1987). The decision of the FERC denying rehearing (App., *infra*, 68a-73a) is reported at 43 F.E.R.C. ¶ 61,046 (1988).

JURISDICTION

The court of appeals rendered its judgment on July 28, 1989. Rehearing was denied on October 12, 1989. App., *infra*, 29a-30a. On January 2, 1990, the Chief

Justice extended the time for filing a petition for a writ of certiorari to and including February 9, 1990. This Court has jurisdiction under 28 U.S.C. § 1254(1).

AUTHORITIES INVOLVED

Section 318 of the Federal Power Act of 1935 provides in relevant part:

> **Conflict of Jurisdiction.** If, with respect to the issue, sale, or guaranty of a security, . . . or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 . . . and to a requirement of this chapter . . ., the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this chapter . . . with respect to the same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this chapter shall apply to such person.

16 U.S.C. § 825q.

STATEMENT

1. Petitioners are fifteen small Ohio villages and cities that purchase wholesale electric power from respondent Ohio Power Company for resale to their residents.[1] Ohio Power is an operating public utility subsidiary of the American Electric Power Company (AEP), which also owns seven other electric utilities operating as an interconnected system in a seven-state area.

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[1] Petitioners include the Villages of Arcadia, Bloomdale, Carey, Cygnet, Deshler, Greenwich, Ohio City, Plymouth, Republic, Shiloh, Sycamore, and Wharton, and the Cities of Bryan, St. Clairsville, and Wapakoneta. Petitioners have populations ranging from approximately 300 to 8500.

Ohio Power purchases coal for generating electricity from its wholly owned subsidiary, the Southern Ohio Coal Company (SOCCO). Coal costs are the dominant component in the total cost of producing electricity from coal-fueled generators; in this case, for example, coal costs make up nearly half of Ohio Power's revenues from sales to petitioners. See Ohio Power Co., Revised Compliance Filing, Docket No. ER82-553-004 (FERC April 24, 1989). Because AEP is a registered public utility holding company, contractual relationships among its affiliated companies are subject to regulation by the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (PUHCA). 15 U.S.C. § 79a(b)(2). The contract by which Ohio Power purchases coal from SOCCO is subject to certain requirements imposed by the SEC under Section 13(b) of PUHCA (15 U.S.C. § 79m(b)), but that contract was never specifically approved by the SEC.

2. In 1982, the Federal Energy Regulatory Commission (FERC) initiated a rate proceeding pursuant to Sections 205 and 206 of the Federal Power Act of 1935 (FPA). 16 U.S.C. §§ 824d & 824e. Acting under its mandate to protect ratepayers from excessive charges, FERC refused to allow Ohio Power to pass through to its customers any portion of its coal costs that did not satisfy the "comparable market test" established in FERC's Opinion No. 133 (*Public Serv. Co. of New Mexico*, 17 F.E.R.C. ¶ 61,123 (1981), *aff'd sub nom. Public Serv. Co. of New Mexico* v. *FERC*, 832 F.2d 1201 (10th Cir. 1987)). Under that test, utilities purchasing coal from affiliates may "recover no more from their ratepayers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier." 17 F.E.R.C. at 61,246. The FERC adopted the comparable market test for two reasons: First, in FERC's judgment, a "market-price limitation on fuel expense recovery from affiliated suppliers provides the best incentive for utilities to de-

velop the least costly sources of fuel." App., *infra*, 42a. Second, that limitation protects consumers from the risks of "self-dealing" and "rate manipulation" that "arise[] in transactions between affiliates." *Id.*

In this case, FERC found that, in purchasing coal from its subsidiary, Ohio Power had paid approximately 50 percent more than the market price in 1980, approximately 94 percent more than the market price in 1981, and approximately 24 to 33 percent more during the period from 1982 to 1986. App., *infra*, 58a n.87. Accordingly, FERC ordered Ohio Power to establish rates calculated to recover from its customers no more than the comparable market price of coal. App., *infra*, 60a-65a. FERC also ordered Ohio Power to refund prior overcharges of approximately $10 million to its wholesale customers, which Ohio Power has done.

During the proceedings before the FERC, Ohio Power contended that the Commission had no jurisdiction over the coal charges Ohio Power passes on to its customers. Ohio Power based that contention upon Section 318 of the FPA, which provides that "[i]f, with respect to . . . any . . . subject matter, any person is subject both to a requirement of [PUHCA] and to a requirement of [the FPA], . . . such person shall not be subject to the requirement of this chapter . . . with respect to the same subject matter." 16 U.S.C. § 825q. Ohio Power argued that it was required by Section 13(b) of PUHCA and the relevant SEC regulations to pay to SOCCO the "costs" of producing coal from SOCCO's mine, including salaries and a return on investment, even if those costs were considerably above comparable market prices. Ohio Power further argued that the SEC's regulation of the "subject matter" of coal contracts ousted FERC of any jurisdiction to regulate the magnitude of the coal charges that Ohio Power could pass on to its customers.

FERC rejected Ohio Power's interpretation of Section 318. FERC observed that the SEC's jurisdiction under PUHCA does not extend to setting rates, as the SEC itself has repeatedly acknowledged. App., *infra*, 34a-40a. Accordingly, FERC held that for purposes of Section 318 the relevant "subject matter" of SEC regulation under PUHCA was the transfer price of coal between SOCCO and Ohio Power, not the "fuel costs Ohio Power may collect from its wholesale customers." App., *infra*, 37a. According to FERC, "setting the intra-corporate price and setting rates are not the same subject matter which would bring section 318 into play." *Id.* FERC concluded that there was therefore "no conflict in the regulation by the SEC and the regulation by this Commission" and, hence, that Section 318 did not oust FERC of jurisdiction. App., *infra*, 37a-38a.[2]

3. A divided court of appeals reversed. The court did not dispute FERC's conclusion that its comparable market test is necessary to protect consumers against the risks of self-dealing and rate manipulation arising from transactions between a public utility and its affiliates. Nor did the court dispute FERC's finding that, during each year from 1981 to 1986, Ohio Power had paid its coal subsidiary between 24 percent and 94 percent more than market prices, and that Ohio Power had passed those inflated costs on to its customers. Nor did the court dispute FERC's determination that the SEC does not, in fact, regulate the fuel charges that are passed on to customers of a public utility subject to PUHCA, and that there is therefore no actual conflict between the SEC's exercise of its jurisdiction under PUHCA and FERC's exercise of jurisdiction under the FPA. Instead, the panel majority agreed with Ohio Power that Section 318 completely ousts FERC of jurisdiction to regulate the fuel charges that a utility may pass along to con-

[2] FERC also disputed Ohio Power's claim that the SEC *requires* Ohio Power to purchase coal from its subsidiary at cost, as opposed to permitting Ohio Power to purchase coal at a price no greater than cost. App., *infra*, 36a.

sumers in its rates if the SEC has any jurisdiction over the contracts by which coal is sold to the utility.

In reaching that conclusion, the majority held, as an initial matter, that FERC is not entitled to any deference in its interpretation of Section 318 of the Federal Power Act. The majority acknowledged that *Chevron USA Inc.* v. *NRDC*, 467 U.S. 837 (1984), and other decisions of this Court require a reviewing court to defer to "'an agency's construction of the statute which it administers.'" App., *infra*, 8a (quoting *Chevron*, *supra*, 467 U.S. at 842). However, the majority held that "Section 318 cannot be said to be entrusted to FERC's administration" because that provision "involves" FERC "only to the extent of FERC's interface with regulation of the regulated entities by the SEC under PUHCA." *Id.* Therefore, according to the majority, the usual rule requiring deference to an agency's statutory interpretation does not apply in this area of jurisdictional ambiguity.

Interpreting the statute *de novo*, the court agreed with Ohio Power's interpretation of the phrase "subject matter" in Section 318. Noting that the SEC has jurisdiction over "the price term of sales contracts between associated companies," the majority argued that "FERC has in effect set by order a different price term for such a contract by determining that it will not allow the contract price as a cost in [Ohio Power's] rate case." App., *infra*, 9a. Thus, the majority found that "the same subject matter is implicated" by the regulations of the SEC and the FERC. App., *infra*, 9a-10a. The majority concluded that Section 318 gives the SEC exclusive jurisdiction over the costs incurred by Ohio Power under contracts with its subsidiaries, even though those costs are passed through to wholesale customers in rates that otherwise would be subject to the exclusive authority of FERC. App., *infra*, 9a-10a, 17a. The court relied for this conclusion upon an analogy to this Court's "preemption of the field" decision in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 970-71 (1986), which held that

FERC's determinations of any issues underlying FERC-set wholesale rates preempt state determinations concerning similar issues in determining retail rates. Because the SEC, in the majority's view, has exclusive jurisdiction over all costs arising from a contract between a PUHCA-regulated utility and its affiliate, the court held that FERC is ousted of jurisdiction even if there is no actual conflict between SEC regulation and FERC regulation. App., *infra*, 14a-16a.

Judge Mikva dissented from this part of the majority's opinion. He argued that Section 318 does not grant the SEC exclusive jurisdiction over all costs arising from a PUHCA-regulated contract. Instead, it grants the SEC paramount authority in the event there is an actual regulatory "conflict" between a SEC requirement and an action taken by FERC. App., *infra*, 19a-20a. In this case, Judge Mikva argued, the contract costs were approved as ceilings by the SEC, but FERC's decision to allow only a part of those costs to be passed on to consumers merely had the effect of lowering those costs below the specified ceilings. App., *infra*, 21a-23a. Thus, Ohio Power could comply with both requirements and simultaneously promote the purposes of both statutes. Therefore, Judge Mikva concluded, there was no conflict in the requirements imposed upon Ohio Power that would warrant ousting FERC's jurisdiction under Section 318. App., *infra*, 23a.[3]

[3] Judge Mikva ultimately concurred in the decision to set aside FERC's order on the ground that, in his view, Rule 35.14(a)(7) of FERC's own rules precludes FERC from disallowing any costs approved by the SEC. Rule 35.14(a)(7) provides that such costs "shall be deemed to be reasonable" for ratemaking purposes. 18 C.F.R. § 35.14(a)(7). In its own decision in this case, the FERC had held that this language merely "creates a *presumption* of reasonableness, not a conclusive finding of reasonableness." App., *infra*, 41a (emphasis added). Judge Mikva, however, disagreed with FERC's interpretation of its regulation, and held that the regulation's language creates a conclusive presumption. App., *infra*, 24a. The majority did not reach, or even comment upon, this issue.

The court of appeals denied rehearing on October 13, 1989. App., *infra*, 29a. Judge Mikva issued a statement urging rehearing because "the panel opinion creates a regulatory gap that can be mischievous in future cases" in "this important and delicate area of inter-agency administration of the law." App., *infra*, 30a. As Judge Mikva explained, "The statutory interpretation engaged in by the majority . . . generates a no-man's land where neither the [SEC] nor FERC will patrol holding company practices which can oppress consumers, investors and the public." *Id.* According to Judge Mikva, "Congress did not intend and our court should not construct such a result." *Id.*

REASONS FOR GRANTING THE PETITION

This case presents two distinct but equally important questions of federal law that have widespread significance not only for federal electric utility regulation, but also for the relationship between federal agencies and reviewing courts. The first, which is a threshold issue in any case of this kind, is whether the deference principles articulated in *Chevron USA Inc.* v. *NRDC*, 467 U.S. 837 (1984), and other decisions of this Court apply to an agency's interpretation of a statute that defines or limits the reach of that agency's jurisdiction. The court below held that those principles do not apply in that circumstance, and in so doing placed itself in conflict with decisions of other courts of appeals, specifically the decision of the First Circuit in *Kokajko* v. *FERC*, 873 F.2d 419, 422-23 (1st Cir. 1989), that of the Third Circuit in *Puerto Rico Maritime Shipping Auth.* v. *Valley Freight Sys.*, 856 F.2d 546, 550-52 (3d Cir. 1988), and that of the Ninth Circuit in *Wyckoff Co.* v. *EPA*, 796 F.2d 1197, 1199-1201 (9th Cir. 1986).

The second issue is whether Section 318 of the FPA ousts FERC of jurisdiction over a wholesale electric

rate matter even though no actual conflict exists between a requirement imposed by that agency pursuant to the FPA and any requirement imposed by the SEC pursuant to PUHCA. The majority held that it does, and in so doing placed itself in conflict with the Fourth Circuit's decision in *Appalachian Power Co.* v. *FPC*, 328 F.2d 237 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964).

The majority's interpretation of Section 318 also creates a substantial "regulatory gap" (to borrow Judge Mikva's phrase) that will permit—indeed encourage—electric utilities to gouge their customers by manipulating the prices utilities pay for goods and services provided by affiliates. As a result, the decision below will have a dramatic impact on electric rates paid by nearly 50 million consumers located in most parts of the country.

1. This Court has repeatedly held that, unless Congress has directly spoken to the precise question at issue, a reviewing court must defer to any reasonable construction of a statute by the agency charged with its administration. See, *e.g.*, *Chevron USA Inc.* v. *NRDC*, 467 U.S. 837, 842-44 (1984); *K Mart Corp.* v. *Cartier, Inc.*, 108 S.Ct. 1811 (1988). As noted above (*supra* p. 6), the majority declined to give any deference to FERC's interpretation of Section 318 of the Federal Power Act, holding that "Section 318 cannot be said to be entrusted to FERC's administration" because that provision deals only with "the extent of FERC's interface with regulation of the regulated entities by the SEC under PUHCA." App., *infra*, 8a.

FERC, as the successor to the Federal Power Commission, is the only agency responsible for administering the Federal Power Act as a whole, and Section 318 is part of the FPA. See Pub. L. No. 74-333, 49 Stat. 838, 839, 863 (codified as amended at 16 U.S.C. § 791 *et seq.*).[4] Accordingly, the court of appeals' holding neces-

[4] The majority's statement that "Section 318 [of the FPA] cannot be said to be entrusted to FERC's administration" (App., *infra*,

sarily rests upon that court's view that Section 318 itself concerns only "the extent of FERC's interface with"—*i.e.*, jurisdiction over—entities that are also regulated by the SEC under PUHCA. In short, the court below held that FERC's interpretation of Section 318 is not entitled to any deference because that provision concerns the extent of FERC's jurisdiction rather than the nature of FERC's regulatory responsibilities.

a. The amount of deference, if any, owed by a reviewing court to an agency's interpretation of a jurisdictional provision in its organic statute is an issue on which the courts of appeals disagree. The decision below follows the law laid down in other decisions of the D.C. Circuit. In *New York Shipping Ass'n* v. *FMC*, 854 F.2d 1338 (D.C. Cir. 1988), *cert. denied*, 109 S.Ct. 866 (1989), for example, the court refused to defer to the Federal Maritime Commission's interpretation of Section 5 of the Maritime Labor Agreements Act of 1980 (46 U.S.C. § 841c). See *id.* at 1362-63. Relying upon a distinction drawn in prior D.C. Circuit decisions between statutes

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8a) cannot be interpreted to mean that Section 318 is not part of FERC's organic statute, as was the case in the decision cited by the majority. *See Department of Treasury* v. *FLRA*, 837 F.2d 1163, 1167 (D.C. Cir. 1988) (declining to give deference to FLRA's interpretation of statutes and regulations administered by Office of Personnel Management). Indeed, the majority opinion repeatedly and correctly recognized that Section 318 is part of the Federal Power Act. *See, e.g.*, App., *infra*, 2a, 4a-5a. (The Federal Power Act, in turn, was originally enacted as Title II of the Public Utilities Act of 1935, of which the Public Utility Holding Company Act was Title I. *See* 49 Stat. 803, 838.) In stating that the FERC does not "administer" Section 318, the majority plainly meant that, unlike nonjurisdictional provisions of the Act, Section 318 contains no substantive regulatory standards which FERC applies. *See, e.g.*, *ACLU* v. *FCC*, 823 F.2d 1554, 1567 n.32 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 959 (1988) (drawing distinction, for *Chevron* purposes, between jurisdictional provisions and "provisions pertaining to the mechanics or inner workings of the regulatory process").

dealing with the substance of an agency's regulatory responsibilities and those dealing with the agency's jurisdiction (*id.* at 1363 n.9), the court held that "it would . . . be inappropriate for us to defer to the agency where, as here, it is interpreting not the meaning of a statute that Congress has charged it to administer, but rather a statute merely delimiting its jurisdiction as against that" of other regulatory agencies (*id.* at 1363 (alternative holding)). At least one other court of appeals—the Eighth Circuit—has joined the D.C. Circuit in squarely holding that an agency is "not entitled to judicial deference" when it construes a provision dealing with the "scope of [its] statutory authority." *Missouri* v. *Andrews*, 787 F.2d 270, 286-87 (8th Cir. 1986), *aff'd on other grounds sub nom. ETSI Pipeline Project* v. *Missouri*, 108 S.Ct. 805 (1988) (refusing to defer to interpretation by Secretary of Interior of Section 9(c) of Flood Control Act).

On the other hand, the First, Third, and Ninth Circuits have held that *Chevron*-style deference *is* required in reviewing an agency's interpretation of its authority under its organic statute. In *Puerto Rico Maritime Shipping Auth.* v. *Valley Freight Sys.*, 856 F.2d 546 (3d Cir. 1988), for example, the Third Circuit upheld as reasonable an interpretation by the ICC of the statutory provision giving the ICC jurisdiction over motor carriers (49 U.S.C. § 10521), even though it noted that, "[w]ere the question being considered as an original matter, one might reasonably prefer" the opposing party's interpretation. 856 F.2d at 551-52. Citing *Chevron*, the court held that the "rule of deference is fully applicable to an agency's interpretation of its own jurisdiction." *Id.* at 552. The Ninth Circuit reached the same conclusion in deferring to the EPA's interpretation of Section 3006 of the Resource Conservation and Recovery Act of 1976 (42 U.S.C. § 6926), which concerns the allocation of responsibility between federal and state authorities in administering that Act. *Wyckoff Co.* v. *EPA*, 796 F.2d

1197, 1200-01 (9th Cir. 1986). Similarly, in *Kokajko* v. *FERC*, 873 F.2d 419, 422-23 (1st Cir. 1989), the First Circuit held that FERC's interpretation of its jurisdiction under Section 10(a) of the Federal Power Act over fees charged by regulated hydroelectric power plants for access to associated recreational property was entitled to *Chevron*-style deference. The decision below, holding that deference is not warranted because Section 318 concerns the limit of FERC's authority, squarely conflicts with each of these decisions.

Aside from this conflict in the circuits, the question whether an agency is entitled to deference when interpreting a statute defining or delimiting its jurisdiction is of substantial importance in administrative law. The significance of that question is well illustrated by the sharply divergent views expressed in the concurring and dissenting opinions in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 108 S.Ct. 2428 (1988). See *id.* at 2443-44 (Scalia, J., concurring in the judgment); *id.* at 2446-47 (Brennan, J., dissenting). As the concurring opinion correctly observed, a large percentage of disputes over the proper construction of administrative statutes are, at bottom, disputes over the agency's jurisdiction or authority. See *id.* at 2444 (Scalia, J., concurring in the judgment).

b. The majority's refusal to defer to FERC was critical to the decision in this case because the majority plainly could not have reached the result it did if it had accorded any deference at all to FERC's interpretation of Section 318. As previously discussed (*supra* p. 4), whether FERC has any jurisdiction under Section 318 over fuel charges arising from coal contracts with an affiliated coal subsidiary depends upon whether FERC is attempting to regulate the same "subject matter" regulated by the SEC. But merely reading the phrase "subject matter" cannot resolve that question: Only if the phrase is interpreted broadly, as Ohio Power proposed, are "coal costs" the relevant subject matter in this case. "Subject

matter," however, also lends itself to a narrower interpretation, under which the coal price charged to Ohio Power by its affiliate is one "subject matter," and the coal-related fuel charges passed through to Ohio Power's customers are a separate "subject matter." See *supra* p. 5.

Recognizing the inherent ambiguity in the statutory phrase, FERC reasonably could consider the title of Section 318, *i.e.*, "*Conflict* of Jurisdiction," as well as other indications of congressional purpose, all of which show that Congress intended to limit the reach of Section 318 to irreconcilable conflicts between a requirement imposed under PUHCA and a requirement imposed by FERC under the FPA. See 16 U.S.C. § 825q; 49 Stat. 803, 863; see also H.R. Rep. No. 1903, 74th Cong., 1st Sess. 75 (1935) (Section 318 covers "any conflict arising under this bill"). On that basis, FERC determined that the statute should be construed to produce overlapping "subject matters" only when the regulatory requirements of the SEC and FERC are in actual conflict. It therefore adopted a narrower interpretation of "subject matter" than that advanced in Ohio Power. See *supra* p. 5. FERC also recognized that, because "[t]he SEC's jurisdiction . . . does not extend to setting rates and determining what fuel costs" an electric utility may collect from its customers (App., *infra*, 37a), Ohio Power's broad interpretation would produce a regulatory gap not contemplated by Congress. Accordingly, FERC interpreted the statute to prevent an outcome that Congress almost certainly would condemn.

On its face, FERC's interpretation is the only sensible reading of Section 318. At a minimum, FERC's interpretation is a reasonable construction of the statutory language and, for that reason, plainly would have been upheld if the court below had granted FERC any deference.

This case thus provides an appropriate and compelling vehicle through which to resolve the question whether a reviewing court must defer to an agency's reasonable construction of a portion of the agency's organic statute defining or delimiting the agency's jurisdiction.[5] To be sure, the jurisdiction problem in this case concerns not only the scope of FERC's authority, but also the SEC's authority. But any consideration of this case on the merits would have to begin with the threshold issue of whether a reviewing court owes deference to an agency's interpretation of any jurisdictional statute. Thus, that issue is squarely posed here.[6] Accordingly, the Court should grant certiorari to resolve the circuit conflict over this important question of administrative law.

2. The majority's interpretation of Section 318 also warrants this Court's attention, quite aside from the court of appeals' refusal to accord any deference to FERC's interpretation. As noted earlier (*supra* p. 6), the majority held that, because Ohio Power's coal costs were subject to regulation by the SEC, FERC was ousted from jurisdiction, even though the SEC was merely regulating the price Ohio Power paid to its affiliate, and even though there is no actual conflict between the two

[5] The court of appeals' observation (App., *infra*, 8a) that FERC did not claim any deference for its interpretation in that court is irrelevant. FERC did not disavow deference. Moreover, the issue is clearly appropriate for resolution now because the court of appeals addressed and squarely decided the issue.

[6] Indeed, both the Eighth Circuit's decision in *Missouri* v. *Andrews*, *supra*, and the D.C. Circuit's decision in *New York Shipping Ass'n*, *supra*, also involved statutes that allocated jurisdiction between two agencies. *See* 787 F.2d at 281-86 (statute allocating authority between Army and Interior departments); 854 F.2d at 1363 (statute allocating jurisdiction between NLRB and FMC). But, like the majority's decision below, those decisions determined that no deference was appropriate based upon the broad principle that an agency's interpretation of its own jurisdiction is not entitled to *Chevron*-style deference. *See supra* pp. 10-11.

agencies' requirements. See *supra* p. 5. In essence, then, the court of appeals applied a "preemption of the field"-type analysis rather than a "conflict preemption"-type analysis in determining how regulatory authority should be allocated between two federal agencies. Compare, *e.g.*, *Nantahala*, *supra*, 476 U.S. at 962-67 (field preemption analysis under "filed rate" doctrine) and *Schneidewind* v. *ANR Pipeline Co.*, 108 S.Ct. 1145, 1151-56 (1988) (field preemption analysis), with *Northwest Central Pipeline Corp.* v. *State Corp. Comm'n*, 109 S.Ct. 1262, 1267-78 (1989) (conflict preemption analysis).[7]

This interpretation of Section 318 conflicts with the decision of the Fourth Circuit in *Appalachian Power Co.* v. *FPC*, 328 F.2d 237, 249-52 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964), which involved one of Ohio Power's sister companies in the AEP system. Relying upon this Court's decision in *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119, 125 (1944), the Fourth Circuit held that "[u]nder section 318 of the Federal Power Act *actual conflicts* between the FPC and the SEC are resolved in favor of the SEC." 328 F.2d at 250 (emphasis added). Applying this interpretation of Section 318, the court upheld certain accounting regulations issued by FERC's predecessor on the ground that those regulations did not conflict with accounting regulations issued by the SEC under PUHCA, even though both sets of regulations covered the same general subject area. *Id.* at 250-52.

In addition to its inconsistency with *Appalachian Power*, the majority's "preemption of the field" approach is incorrect for at least three reasons. *First*, as discussed above (*supra* p. 13), that approach is at odds with the language and structure of Section 318 itself. *Second*, the rationale underlying the "preemption of the field" ap-

[7] The majority's reliance upon this Court's decision in *Nantahala*, *supra*, for this holding is particularly ironic, inasmuch as the underlying principle of that decision is deference to FERC in ratemaking matters. *See* 476 U.S. at 962-67.

proach is inapplicable here. Acts of Congress dealing with interstate commerce can remain "supreme and exclusive" if state laws are preempted not only when they actually conflict with federal law, but also when they may "interfere with federal authority over the same activity." *Nantahala Power & Light Co.* v. *Thornburg*, *supra*, 476 U.S. at 964 (quoting *Chicago & North Western Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 318-19 (1981)). That rationale does not apply to potential overlaps in the jurisdictions of two or more federal agencies, because federal authority remains supreme regardless of which agency actually regulates the particular matter at issue. *Third*, as Judge Mikva recognized, the majority's approach creates an obvious "gap" in the federal regulatory system whenever the agency retaining jurisdiction has in fact failed to occupy the entire field. See App., *infra*, 30a.[8]

[8] Judge Mikva's decision to concur in the result on the basis of Section 35.14(a)(7) of FERC's own rules does not undermine the importance of the majority's interpretation of Section 318. Although he recognized the principle that a reviewing court should defer to an agency's interpretation of its own rules (*see* App., *infra*, 24a), Judge Mikva failed to heed that principle in concluding, contrary to FERC's long-standing interpretation, that the word "deemed" in Section 35.14(a)(7) *necessarily* establishes a conclusive presumption that any charges approved by the SEC are reasonable. *See supra* n.3; *cf. McDowell County Consumers Council* v. *American Elec. Power Co.*, 54 F.P.C. 361 (1975) (§ 35.14 does not establish conclusive presumption); 15 F.E.R.C. ¶ 61,257 at 61,592-93 (1981) (same). The word "deemed" is frequently used to connote merely a rebuttable presumption. *E.g., Lavine* v. *Milne*, 424 U.S. 577, 583 (1976); *Gaither* v. *Myers*, 404 F.2d 216, 218 (D.C. Cir. 1968); *Hardy* v. *Lomenzo*, 349 F. Supp. 617, 621 (S.D.N.Y. 1972). FERC's interpretation, therefore, is not at odds with the plain meaning of its own regulation, and is therefore entitled to deference under well-settled principles. *See, e.g., Jewett* v. *Comm'r*, 455 U.S. 305, 318 (1982); *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965); *Western Union Telegraph Co.* v. *FCC*, 815 F.2d 1495, 1503 (D.C. Cir. 1987).

But, even if Judge Mikva were correct, his approach would have left FERC free to regulate the ratemaking consequences of

The decision below also warrants this Court's attention because it creates a substantial risk that future decisions of the D.C. Circuit and of other federal courts will apply the majority's erroneous "preemption of the field" approach in cases involving the allocation of jurisdiction between federal agencies, thereby creating gaps in other federal regulatory schemes. Review by this Court is necessary to prevent that result, and to resolve the conflict between the decision below and the Fourth Circuit's decision in *Appalachian Power*.

3. Aside from the doctrinal importance of the issues decided by the majority, the decision below will have a dramatic impact on electric utility rates paid by the direct and indirect customers of every electric utility company subject to PUHCA. Those companies serve, directly or indirectly, approximately 49 million households and businesses in 30 states and the District of Columbia. See Federal Energy Regulatory Commission, FERC Form 1, Annual Reports of Major Electric Utilities, Licensees and Others (1988); Electrical World, Directory of Electric Utilities (98th ed. 1990). Those companies account for approximately 16 percent of revenues generated by all electric utilities. See Securities and Exchange Commission, Financial and Corporate Report on Holding Companies Registered Under the Public Utility Holding Company Act of 1935 (Dec. 31, 1988) ("SEC Report") (PUHCA-regulated utilities account for 20.2 percent of all revenues by investor-owned utilities); Energy Information Administration, Annual Outlook For United States Electric Power 1989 at 37 (investor-owned utilities account for approximately 80 percent of total elec-

transactions between electric utilities and their affiliates prospectively. FERC could simply rescind or modify its regulation, and would then be free under Section 318 to exercise regulatory oversight over efforts by PUHCA-regulated electric utilities to pass unreasonable costs on to their customers. Under the majority's approach, by contrast, FERC is helpless to protect ratepayers.

tricity generation). Together, electric utilities subject to PUHCA have assets in excess of $80 billion, and annual revenues (as of 1988) in excess of $27 billion. SEC Report at 2. In addition to numerous coal subsidiaries, these companies also have nuclear fuel subsidiaries, fuel oil subsidiaries, real estate subsidiaries, communications subsidiaries, leasing subsidiaries, credit subsidiaries, legal and accounting subsidiaries, engineering subsidiaries, construction subsidiaries, electric generation subsidiaries and assorted other subsidiary service companies. See *id.* at 12-65.

The decision below held that the mere existence of SEC jurisdiction over a particular transaction between an electric utility subject to PUHCA and any affiliated company completely insulates all aspects of that transaction from future ratemaking review by FERC, no matter what effect the transaction has on the electric rates subject to review by FERC. Inasmuch as any challenge to a FERC rate order can be brought in the D.C. Circuit (see FPA § 313(b), 16 U.S.C. § 825*l*(b)), the court of appeals' decision will effectively eliminate FERC jurisdiction over the rate consequences of all such transactions. The decision below thus makes it impossible for FERC to protect nearly 50 million ratepayers against potential self-dealing, unnecessary "gold plating" of plant and equipment, and rate manipulation arising from transactions between electric utilities and their affiliates. The decision below, moreover, creates a strong incentive for electric utilities to adopt the holding company form, and for new and existing holding companies to create new subsidiaries to provide every conceivable good and service needed for the generation, transmission and distribution of electricity. The decision, therefore, could lead to a major restructuring of the entire industry, contrary to Congress's goal, articulated in PUHCA itself, of discouraging public utility holding companies and the abuses that attend them. See 15 U.S.C. § 79a(b)(2).

The SEC, moreover, lacks both the statutory authority and administrative apparatus necessary to protect ratepayers against these harmful consequences. The SEC, unlike FERC, has no statutory or administrative procedures by which a customer can initiate a complaint. Cf. FPA § 206; 16 U.S.C. § 824e. And the SEC, unlike FERC, has no clear statutory authority to order refunds for overcharges if a utility is found to have violated the SEC's regulatory requirements. Cf. FPA § 205(e), 16 U.S.C. § 824d. Indeed, the SEC has repeatedly recognized that it has "no power over the[] dealings [of electric utilities regulated under PUHCA] with their customers, retail or wholesale." *American Elec. Power Co.*, 46 S.E.C. 1299, 1323 (1978); accord *Louisiana Power & Light Co.*, 26 S.E.C. Docket 1257, 1263 (1982); *New England Elec. Sys.*, 24 S.E.C. Docket 229, 235 (1981); *Arkansas Power & Light Co.*, 45 S.E.C. 567, 574 (1974); *Vermont Yankee Nuclear Power Corp.*, 43 S.E.C. 693, 699 (1968). The decision below, therefore, creates a serious gap in the regulation of electric utilities subject to PUHCA, a gap that could not be filled by the SEC even if it wanted to.

This case well illustrates the effects of this regulatory gap on consumers. As previously noted (*supra* p. 4), FERC found that the prices Ohio Power paid its subsidiary for coal exceeded market prices by 24 percent to 94 percent from 1981 to 1986, and it required Ohio Power to make corresponding reductions in its wholesale rates. Inasmuch as coal costs represent approximately half the costs of generating electricity from coal-fired generators (*supra* p. 3), the rates paid by petitioners (and, therefore, their residents) between 1981 and 1986 were 12 to 47 percent higher than they would have been if the coal cost component of those rates had been limited to market prices. Thus, the decision below not only will require petitioners (and their residents) to repay to Ohio Power the substantial overcharges that FERC ordered refunded to petitioners, but also, in all likelihood, will lead to sub-

stantial increases in the rates petitioners must now pay for electricity. All of the nearly 50 million households and businesses that receive electricity directly or indirectly from electric utilities subject to PUHCA can reasonably expect similar increases as a result of the decision below, increases they would not face if their electric utilities were not subject to PUHCA.

In short, the panel's decision creates a "no-man's land" in an "important and delicate area of inter-agency administration of the law." App., *infra*, 30a (Mikva, J.). Far from creating a mere academic curiosity, the decision below will produce a substantial and inequitable hardship for millions of electric utility ratepayers in most parts of the country. Only review by this Court can avert the doctrinal and economic mischief created by the court of appeals' decision.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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February 9, 1990

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

No. 88-1293

OHIO POWER COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

LCP CHEMICALS & PLASTICS, INC., *et al.*,
MUNICIPAL WHOLESALE ELECTRIC CUSTOMERS OF
OHIO POWER COMPANY,
Intervenors.

Argued Feb. 24, 1989

Decided July 28, 1989

Petition for Review of an Order of the
Federal Energy Regulatory Commission

Edward Berlin, with whom Andrew L. Lipps, Kenneth G. Jaffe, Washington, D.C., and Edward J. Brady, were on the brief, for petitioner.

Joanne Leveque, Attorney, F.E.R.C., with whom Catherine C. Cook, Gen. Counsel, and Joseph S. Davies, Deputy Sol., F.E.R.C., Washington, D.C., were on the brief, for respondent.

John Estes also entered an appearance for respondent.

Gregg D. Ottinger, Washington, D.C., and T.D. Kauffelt, Charleston, W. Va., were on the brief, for intervenors, Municipal Wholesale Electric Customer of Ohio Power Company and Industrial intervenors.

Before MIKVA, SILBERMAN, and SENTELLE, Circuit Judges.

Opinion for the Court filed by Circuit Judge SENTELLE.

Concurring opinion filed by Circuit Judge MIKVA.

SENTELLE, Circuit Judge:

The Federal Energy Regulatory Commission (FERC) determined in a rate proceeding that Ohio Power Company's cost of coal purchased from an associated company was unreasonably high. The company has petitioned us to vacate the order on the grounds that it is for the Securities and Exchange Commission (SEC) to determine the reasonableness of contracts between associated companies. We grant the petition for the reasons set out below.

I. Background

A. *The Statute*

The central issue raised by petitioner concerns the applied meaning of the phrase "subject matter" in section 318 of the Federal Power Act (FPA), 16 U.S.C. § 825q, an issue to which section 13(b) of the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. § 79m(b), is relevant. FPA § 318 and PUHCA § 13 were enacted in different titles of the Public Utility Act of 1935, ch. 687, 49 Stat. 803 (1935) (codified as amended principally at 15 U.S.C. §§ 79 to 79z-6 and 16 U.S.C.

§§ 824-825r (1982 & Supp. V. 1987)), which initiated federal regulation of public utility holding companies theretofore insulated from effective state-level regulation by their multi-state operations. The broadly remedial purposes of the Public Utility Act included protection of investors, consumers, and the public from various abusive holding company practices, including non-arm's-length contracts within an associated group. *See* 15 U.S.C. § 79a(b)(2). (The definitions of public utility holding company, associate company, and similar terms are set out in section 2 of PUHCA, 15 U.S.C. § 79b. Those definitions are applicable to the present case but not in dispute.)

More particularly for our purposes, PUHCA § 13(b) makes unlawful contracts between associates of a public utility holding company,

> except in accordance with such terms and conditions and subject to such limitations and prohibitions as the [SEC] . . . shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies.

15 U.S.C. § 79m(b).[1] The SEC's Rule 90 prohibits associated companies from making or performing contracts

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[1] The full text of section 13(b) is as follows:

> After April 1, 1936, it shall be unlawful for any subsidiary company of any re[illegible]ed holding company or for any mutual service company, b[illegible]e of the mails or any means of instrumentality of interstate commerce, or otherwise, to enter into or take any step in the performance of any service, sales, or construction contract by which such company undertakes to perform services or construction work for, or sell goods to, any associate company thereof except in accordance with such terms and conditions and subject to such limitations and prohibitions

for sale of goods or performance of services "at more than cost." 17 C.F.R. § 250.90(a)(2)(1988). Under the SEC's Rule 91, a transaction is deemed to meet that standard when the price "does not exceed a fair and equitable allocation of expenses . . . plus reasonable compensation for necessary capital procured through the issuance of capital stock. . . ." 17 C.F.R. § 250.91(a). The sale between associates of seller-produced goods is not "limited to cost," 17 C.F.R. § 250.90(d)(2), but such a seller still may not charge its associate more than a fair market price. 17 C.F.R. § 250.92(b).

Under the concurrently enacted provisions of the FPA, FERC regulates the justness and reasonableness of wholesale rates for electric power in interstate commerce. 16 U.S.C. §§ 824, 824d, 824e.[2] FERC's authority includes the power to determine that a "contract affect-[ing]" such a rate is "unjust, unreasonable, unduly discriminatory or preferential" and to prescribe a just and reasonable contract. 16 U.S.C. § 824e(a). Section 318

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as the [SEC] by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies. This provision shall not apply to such transactions as the [SEC] by rules and regulations or order may conditionally or unconditionally exempt as being necessary or appropriate in the public interest or for the protection of investors or consumers, if such transactions (1) are with any associate company which does not derive, directly or indirectly, any material part of its income from sources within the United States and which is not a public utility company operating within the United States, or (2) involve special or unusual circumstances or are not in the ordinary course of business.

15 U.S.C. § 79m(b).

[2] This power originally resided in the Federal Power Commission, of which FERC is the successor agency. 42 U.S.C. §§ 7172(a)(1)(B) & 7293 (1982).

of the FPA provides that, in the absence of an SEC-granted exemption, the requirements of PUHCA govern when a company is subject both to a requirement of the SEC-administered PUHCA (including rules, regulations, and orders thereunder) "with respect to [an itemized list not at issue here] *or any other subject matter*" and of the FERC-administered FPA (including rules, regulations, and orders thereunder) "with respect to *the same subject matter*." 16 U.S.C. § 825q (emphasis added).

B. *OPCO, SOCCO, and the SEC*

Petitioner Ohio Power Company (OPCO) is an operating public utility subsidiary of American Electric Power Company, Inc. (AEP), a public utility holding company subject to PUHCA. OPCO purchases coal from its wholly-owned subsidiary Southern Ohio Coal Company (SOCCO) on esentially a cost-pass-through basis. Because both are associates of a public utility holding company, it is unquestioned that the coal-sale transactions between OPCO and SOCCO are subject to SEC jurisdiction under section 13(b).

The SEC has issued four orders that touch on the price of the OPCO-SOCCO coal transactions. *Ohio Power Company*, Holding Co. Act Release No. 17,383 (Dec. 2, 1971), permitted OPCO to inject capital into the corporate shell of SOCCO so SOCCO could develop OPCO-owned coal reserves "to assure a reliable supply of coal." *Id.* The SEC noted that, under the proposal before it, SOCCO's charges to OPCO would be "based on" its actual costs plus a rate of return on capital no greater than that approved for OPCO by the Federal Power Commission, FERC's statutory predecessor. *Id.* at 2. There were no hearings and no findings, other than the ultimate finding that the proposed transaction was in the interest of the public, investors, and consumers. The order concluded with a "proviso that nothing in this order shall be construed as in any manner affecting the

jurisdiction of any other regulatory authority with respect to the accounting or similar matter in connection with the proposed transactions." *Id. Ohio Power Company*, Holding Co. Act Release No. 20,515, 14 S.E.C. Docket 928 (Apr. 24, 1978), approved OPCO's sale of its coal mines and leases to SOCCO and its further capital contribution to SOCCO. Again, the SEC stated that "[t]he price at which SOhio [SOCCO] coal is sold to AEP system companies will not exceed the cost thereof to the seller." *Id.* at 929.

The SEC required both OPCO and SOCCO to file quarterly financial statements and statements setting out "the quantities of coal sold to each buyer, the price of such coal and the method used to compute the cost of coal sold." *Id.* at 930. *Southern Ohio Coal Co.*, Holding Co. Act Release No. 21,008, 17 S.E.C. Docket 310 (Apr. 17, 1979), approved borrowings by SOCCO intended to reduce the cost of coal by providing cheaper capital. *Southern Ohio Coal Co.*, Holding Co. Act Release No. 21,537, 19 S.E.C. Docket 1309 (Apr. 25, 1980), approved additional OPCO investment in SOCCO to finance capital improvements expected to reduce the cost of coal to SOCCO's buyers. As in the previous decisions, the last order adverted briefly to the contractual relation between the associates: "The price at which [SOCCO's] coal will be sold to AEP system companies will not exceed the cost thereof to the seller. For this purpose, cost will include reasonable compensation for necessary capital." *Id.* The SEC cited sections 6, 7, 9, 10, and 12 of PUHCA, 15 U.S.C. §§ 79f, 79g, 79i, 79j, 79*l*, as authority for its various orders. None of the orders cite section 13(b) as authority.

C. *The Decision Below*

The present dispute arose in a rate proceeding initiated in 1982. All issues settled except the extent to which OPCO could include its costs for "captive coal"

purchased from SOCCO in its recoverable cost of service. *Ohio Power Co.*, 39 F.E.R.C. ¶ 61,098, at 61,274 (1987). The Administrative Law Judge (ALJ) determined that section 318 and FERC's own regulations did not bar FERC's examination of the reasonableness of OPCO's captive coal purchases and that OPCO's coal costs had not been shown to be unreasonable. *Id.* at 61,275. The full Commission affirmed the ALJ's determination that the reasonableness of OPCO's captive coal costs were subject to review but determined that the price of the captive coal unreasonably exceeded a comparable market price. *Id.*

On the threshold section 318 issue, the ALJ had reasoned that the SEC's regulation of the "intra-corporate price of [captive] coal" was not the "same subject matter," in the section 318 sense, as FERC's regulation of utility rates. *Id.* at 61,276. FERC agreed for two reasons. First, FERC questioned whether the SEC had set the price of captive coal at cost, since it was "not clear" that the SEC statements regarding whether the price would be "based on" and "not exceed" cost had mandated a cost floor as well as ceiling. *Id.* FERC also cited the SEC's Rule 92, 17 C.F.R. § 250.92, prohibition of inter-associate sales of goods "at a price which exceeds the price at which the purchasers might reasonably be expected to obtain comparable goods elsewhere," which FERC interpreted as indicating that the SEC might require a below-cost market price, *id.*, and SEC authority for above-cost market prices, *id.* at 61,290 n. 17. FERC indicated that OPCO might apply this authority to the SEC for a market-based section 13 price.

Second, FERC reasoned that setting the inter-associate price, assuming the SEC had in fact done that, simply was not "the same subject matter," in the section 318 sense, as setting wholesale utility rates and determining what costs may be recovered therein. *Id.* at 61,276-77. FERC cited in support SEC staff disclaimers that SEC

section 13(b) orders set rates and an SEC section 13(b) exemption decision that purportedly recognized FERC's rate-making power to allow utilities within its jurisdiction to recover either SEC-authorized costs "or some other amount." *Id.* at 61,277 (quoting *New England Electric System*, Holding Co. Act Release No. 22,309, 24 S.E.C. Docket 298, 307-08 (Dec. 9, 1981)).

The SEC has not appeared in this cause.

II. Analysis

A. *Statutory Interpretation*

Before undertaking our analysis of FERC's interpretation of section 318, we note that FERC does not claim for its interpretation the deference to administrative agencies mandated by *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984), nor is such deference warranted. While *Chevron* requires us to defer to "an agency's construction of the statute which it administers," *id.* at 842, 104 S.Ct. at 2781, "when an agency interprets a statute other than that which it has been entrusted to administer, its interpretation is entitled to no deference." *Department of Treasury v. FLRA*, 837 F.2d 1163, 1167 (D.C. Cir. 1988). Section 318 cannot be said to be entrusted to FERC's administration. Certainly it involves FERC, but only to the extent of FERC's interface with regulation of the regulated entities by the SEC under PUHCA. Therefore, FERC has rightly claimed no deference for its interpretation, and we afford none.

FERC's statutory interpretation rested on two rationales: (1) that there is no conflict between the approaches of the SEC and FERC and (2) that the same subject matter is not involved. We discuss these in the order of their acknowledged importance.

1. The Subject Matter Involved

FERC primarily relied on its determination that its decision and the SEC's decisions do not deal with "the same subject matter" because FERC is regulating rates whereas the SEC is regulating inter-associate transactions. Section 318 governs conflicts regarding "the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter." 16 U.S.C. § 825q. FERC suggests in this Court that the present subject is somehow not a subject within the contemplation of section 318 because Congress enumerated certain matters in section 318 with respect to which the SEC has jurisdiction under PUHCA, *see* 15 U.S.C. §§ 79f-79g, 79i-79j, 79n-79o, but did not mention the non-enumerated subject under discussion.

We cannot accept this suggestion. Congress concluded its enumeration in section 318 with the phrase "or any other subject matter," and the inclusiveness of these words cannot be avoided, as FERC would have us do, by speculating that "Congress simply wanted to include a provision that would cover some unanticipated 'conflict' that might arise." Brief for Respondent at 21 n. 21. The price term of sales contracts between associated companies are subject to SEC jurisdiction under PUHCA, just as are the enumerated subjects, and are therefore a "subject matter" under section 318 if such price term is also subject to the requirements of the FPA or of FERC's rules, regulations or orders thereunder. 16 U.S.C. § 825q. FERC has in effect set by order a different price term for such a contract by determining that it will not allow the contract price as a cost in OPCO's rate case. *See Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 971, 106 S.Ct. 2349, 2359, 90 L.Ed.2d 943 (1986). The conclusion that the same subject matter

is implicated is inescapable. Nor can we subscribe to FERC's analysis that the same subject matter is not involved because it sets rates and the SEC does not. Simply put, FERC's reasoning proves too much because under such an analysis there could never be a conflict between the SEC and FERC with respect to a matter not specifically enumerated in section 318. The absence of conflict would not be *malum in se*, of course, but we presume Congress contemplated that in fact it had conferred on the SEC jurisdiction over some non-enumerated matters that otherwise would fall within the jurisdiction of FERC, and it therefore included the residuary phrase in section 318 to govern those conflicts. FERC's reading renders the residuary language of section 318 meaningless to that extent, and such constructions are disfavored. *See, e.g., National Ass'n of Recycling Indus. v. ICC*, 660 F.2d 795, 799 (D.C. Cir. 1981). In addition, we note that the Supreme Court has held in an analogous situation that a state's "undoubted jurisdiction over retail rates" does not empower it to redetermine issues underlying FERC-set wholesale rates. *Nantahala Power & Light*, 476 U.S. at 970, 106 S.Ct. at 2358.

Moreover, the purposes for which the SEC is to exercise jurisdiction are not as limited as FERC describes them. The ALJ, whose reasoning was affirmed by FERC, 39 F.E.R.C. at 61,275, described the SEC's purposes as ensuring "that no one of the associated companies takes advantage of any other," *Ohio Power Co.*, 25 F.E.R.C. ¶ 63,060, at 65,183 (1983), and "keeping a reasonable arm's length relationship between the two associated companies." *Id.*

These are true statements as far as they go, but they disregard the SEC's statutory charge to exercise its power in the interest of consumers, as well as of investors and the public, and "to insure that such contracts are performed *economically and efficiently*," as well as "at cost." 15 U.S.C. § 79m(b) (emphasis added). Whether

and how well the SEC has discharged the full scope of its statutory duties was not before FERC and is not before us. It is sufficient for present purposes that the SEC is charged by the statute with regulating the terms of affiliate contracts in the interest of consumers, as well as investors and the public, and has not exempted the instant contract. Moreover, we observe, such purposes as the ALJ imputed to the SEC are barely distinguishable, if at all, from considerations cited by FERC itself in favor of a market test: "protection from the prospect of self dealing," and "a substitute for . . . arms-length negotiations." 39 F.E.R.C. at 61,279. The "economic efficiency" FERC seeks to promote by the market test, *id.*, echoes the "economically and efficiently" language of section 13(b) itself. The market and at-cost tests thus seem simply different means to the same end. When Congress enacted PUHCA, however, it specified a particular means to that end for companies subject to PUHCA, and neither we nor FERC are empowered to overrule that express legislative choice for companies within the jurisdiction of the SEC.

We are not persuaded otherwise by the ambiguous disclaimers of rate-setting authority by the SEC and its staff quoted by FERC in its opinion. *See* 39 F.E.R.C. at 61,277-78. The SEC clarifies nothing we need to understand by disclaiming "ratemaking" authority: plainly, that is not its statutory mandate nor the issue here. The issue is the effect to be given in a ratemaking proceeding to the SEC's price-term regulation. The statement of the SEC staff has little weight, but we note it asserts that the SEC *does* fix a pricing formula and refers to the intermediate steps between its decision and ratemaking in a manner that suggests that the SEC's staff believes that FERC is free to set rates based on *other* considerations. 39 F.E.R.C. at 61,277. *Cf. Nantahala Power & Light*, 476 U.S. at 967-68, 106 S.Ct. at 2357-58. The SEC staff also stated that FERC " 'has jurisdiction to try issues, both of fact and of interpretation, in applying

such orders, insofar as material, to a particular rate case,'" 39 F.E.R.C. at 61,277,[3] but that too is not dispositive of the present question because it does not speak —by its own terms, could not speak—to what considerations govern the effect FERC is to give the SEC's determination.

The purported disclaimer by the SEC itself similarly fails to speak clearly, if at all, to the question before FERC and before us. In *New England Electric System*, Holding Co. Act Release No. 22,309, 24 S.E.C. Docket 298 (Dec. 9, 1981), the SEC had before it New England Power Company's (NEPCO) application for a section 13(b) exemption for the proposed future charter of a collier then under construction. In the paragraphs quoted by FERC, 39 F.E.R.C. at 61,277-78, the SEC determined that it could not then assess whether the complex pricing provisions of the future, twenty-five year charter would conform with section 13(b)'s at-cost requirements. On the other hand, the SEC decided that it would not retain jurisdiction because "other regulatory effects . . . allay our concern." 24 S.E.C. Docket at 307. Specifically, the SEC referred to FERC's FPA jurisdiction: "The rates allowed to NEPCO include, as a cost of service, its cost of fuel, which as allowed to NEPCO may include either the entire cost of transportation under the joint venture's charter to NEPCO, if FERC should determine that it is just and reasonable, or some other amount." *Id.* at 308. Because the case clearly is an exemption case, however, it is unclear whether the SEC was stating (1) its understanding that SEC at-cost determinations are irrelevant to FERC rate-setting determinations or (2) the effects that would follow upon its granting of the exemption and the consequent lifting of whatever bar section 318 might

[3] Quoting "Comment of the Division of Corporate Regulation of the Securities and Exchange Commission on the Federal Energy Regulatory Commission Staff Preliminary Report of Investigation in FERC Docket No. E-9206, dated July 31, 1978."

otherwise impose. Because an exemption by the SEC lifts the bar of section 318 to action by FERC, 16 U.S.C. § 825q, we are not persuaded that the decision supports the proposition that FERC may use "some other amount" when the SEC does not grant exemption from the cost standard.

The clearest statement by anyone associated with the SEC on the effect, in the absence of an exemption, of SEC section 13(b) determinations on FERC rate determinations that has been brought to our attention is the prepared statement of the SEC submitted to a congressional committee contemplating amendment of PUHCA. The statement, which advocated repeal of PUHCA, referred to FERC's adoption of a market test for affiliate contracts, the SEC's understanding that section 13 requires a cost standard for such transactions, and the SEC's conclusion that therefore a different federal standard applied to those companies associated with public utility holding companies than applied to those not so associated. *The Public Utility Holding Company Act of 1935: Hearings on H.R. 5220, H.R. 5465 and H.R. 6134 before the Subcommittee on Energy Conservation and Power of the Committee on Energy and Commerce, House of Representatives*, 97th Cong., 2d Sess., at 582-83 (1982). (The SEC's recommendation to repeal PUHCA, of course, was not enacted.)

Finally in this respect, we note that FERC properly has abandoned in this Court its citation below, 39 F.E.R.C. ¶ 61,098, at 61,290 n. 18 & accompanying text at 61,277, of *Mississippi Indus. v. F.E.R.C.*, 808 F.2d 1525, 1550-51 (D.C. Cir. 1987) (per curiam), as authority for its jurisdiction in the present case. The contracts at issue there were characterized as contracts for the sale of electricity between associated companies and therefore outside the scope of the SEC's jurisdiction. *See id.; compare* 15 U.S.C. § 78m(b) *with* 15 U.S.C. § 79b(a)(20).

2. The existence of Conflict

FERC's first-stated, but less important, rationale was that no jurisdictional conflict arises because the SEC *may* require market pricing and "it is not clear," 39 F.E.R.C. at 61,276, that the SEC's orders in the present case impose a cost floor as well as a cost ceiling. As to the first contention, FERC cites the SEC's Rule 92, which provides that the price for seller-produced goods between associated companies may not exceed "the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere." 17 C.F.R. § 250.92. As to the second, FERC's opinion notes that the SEC orders never state that SOCCO's price must equal cost, only that it will be "based on" and "not exceed" cost. In this Court, FERC points additionally to the boiler-plate character of the language in the SEC orders regarding the interest of the public, investors, and consumers: to the absence of any findings by the SEC on the reasonableness of the SOCCO-OPCO charges; to the absence of any findings that the coal price should be passed through to rate payers; and to the absence of evidence that the SEC was "closely monitoring" all costs to ensure efficiency.

We cannot accept this rationale either because it proceeds from a false premise that the bar of section 318 applies only when there is a present conflict between SEC and FERC prescriptions. The language of section 318 in fact bars FERC jurisdiction whenever a person is "subject . . . to a requirement," 16 U.S.C. § 825q, of PUHCA. OPCO plainly is so subject to section 13(b) with respect to its contractual relations with SOCCO. The fact that FERC's market approach produces a current result that does "not exceed" cost, in the words of the SEC's 1978 and 1980 orders, does not make OPCO any less subject to section 13(b) or to the SEC's orders. In the absence of exemption, it is for the SEC rather than FERC to determine the inter-associate price.

FERC suggests that OPCO may apply to the SEC for approval of a market-based rate. 39 F.E.R.C. at 61,290 n. 17. The suggestion is not well-taken because it reverses Congress's section 318 decision that the SEC has the right of first refusal, as it were, in making such determinations. The statutory scheme simply does not contemplate that FERC will make the determination and then send the subject company to the SEC for a conforming order.

Although it does not affect our decision, we must agree with FERC that it *is* "not clear" from the orders in question that the SEC was particularly mindful of its statutory powers and obligations under section 13(b). The SEC orders devoted some attention to the cost of capital to SOCCO and to the cost of coal to that extent. But it is only to that extent that any concern with the cost of coal is evident. None of the four orders cites section 13, nor mentions expressly whatever purchase agreement exists between SOCCO and OPCO, nor describes any element of costs other than the cost of capital. We note that section 13(b) and the SEC's regulations thereunder do not appc to require submission of and approval of inter-asso te agreements but only conformity of the same with the SEC-promulgated rules. Accordingly, OPCO's assertion that the SEC "approved" the sales agreement between OPCO and SOCCO is problematic, and the references in the orders are consistent with, and may be no more than, references in passing to SOCCO's apparent election of, and unexamined representations of conformity with, the Rule 91 at-cost method. We also note, however, that Rules 90 and 91 are regulations under section 13(b) and as binding thereunder as an individualized order. We note as well that the SEC's 1978 Order *did* require OPCO to submit quarterly reports on the price of coal and how the price was computed. All these matters taken into account, our decision nevertheless rests on the threshold matter of the language of the statute, which commits the determina-

tion of the inter-associate price to the SEC. Whether the SEC acquaints itself well or ill is not our present concern.

B. *Trapped Costs*

Although based upon the language of the statute, our decision is also informed by consideration of the consequences of FERC's action in effectively prescribing an inter-associate price. Accordingly, our decision is buttressed by the consistency of its consequences with Supreme Court precedents that disfavor conflicting regulation resulting in trapped costs. In *Nantahala Power & Light*, the Supreme Court held that it was impermissible for a retail-rate-setting state utility commission to "trap" costs by making a different allocation between related companies of a fixed quantity of low-cost power than had FERC at the wholesale level. 476 U.S. at 970-71, 106 S.Ct. at 2358-59. (The PUHCA was not involved.) In a passage that is particularly instructive, the Court indicated that

> FERC's failure actually to reform the AA [the agreement between the related companies] does not materially alter [the] analysis. FERC ordered Nantahala to adjust its wholesale rates so that its average cost per unit of power reflected an allocation of [low-cost] entitlements power different from the allocation set forth in the AA. The effect of that order is, for purposes of this case, essentially the same as reformation of the agreement itself. . . . By adopting a different allocation, NCUC [the state agency] imputes to Nantahala a different average cost of power, notwithstanding the fact that, under the AA, Nantahala unquestionably is not entitled to demand that [allocation]. Consequently, Nantahala is exposed to "trapped" costs. It must, under NCUC's order, pretend that it is paying less for the power it receives from TVA, under agreements

> not subject to NCUC's jurisdiction, than is in fact the case.

Id. at 971, 106 S.Ct. at 2359. Although the parallels to the present case are not precise, there are two quite clear lessons in the passage: First, it is sufficient that FERC's action in the present case reforms the agreement between OPCO and SOCCO in effect rather than in fact. Second, the cost-trapping "pretense" occasioned thereby is prohibited. In the case of *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, —— U.S. ——, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988), FERC had allocated responsibility for purchasing the expensive power generated by the Middle South Utilities system's Grand Gulf 1 nuclear power plant among the system's multiple operating companies on a certain basis. The State of Mississippi, however, claimed the power to disregard FERC's determination with respect to the operating company within its jurisdiction because FERC had not actually considered the prudence of building Grand Gulf 1 and therefore had not preempted Mississippi's power to do so. The Supreme Court held that *Nantahala Power & Light* controlled and preemption did *not* turn on whether the particular matter of prudence was actually decided by FERC. 108 S.Ct. at 2438-42.

Given the clear and express statutory allocation of jurisdiction between federal agencies in section 318, *Nantahala Power & Light* and *Mississippi Power & Light* are not distinguishable from the present circumstances simply because they involved state-federal relations or because FERC must be re-cast in the role of the respective states with the SEC taking the role formerly played by FERC. As FERC points out, however, the Court did not rule in either *Nantahala Power & Light* or *Mississippi Power & Light* on the authority of a state (and by analogy, FERC in the present circumstances) to second-guess the utility on the *quantity* of price-regulated power it should have purchased when cheaper power was available. 476 U.S. at 972, 106 S.Ct. at 2359; 108 S.Ct. at 2440. That

question has been answered favorably to a state (and, by analogy, favorably to FERC in the present circumstances) in *Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 837 F.2d 600, 606-11 (3d Cir.1988). We have no occasion to consider this rationale, however. It plainly was not part of FERC's analysis below, and an agency's order must be affirmed on the basis stated in its opinion or not at all. *Federal Power Comm'n v. Texaco Inc.*, 417 U.S. 380, 397, 94 S.Ct. 2315, 2326, 41 L.Ed.2d 141 (1974).

FERC also argues that there is no "trapping" because FERC has stated that it will allow OPCO to recover in its rates, when the facts warrant, a fair market value for its captive coal in excess of its costs therefor. *See Public Serv. Co. of N.M.*, 17 F.E.R.C. ¶ 61,123 (1981) (Opinion No. 133), *aff'd in pertinent part sub nom. Public Serv. Co. of N.M. v. FERC*, 832 F.2d 1201 (10th Cir.1987) (non-SEC case). The difficulty with this element of FERC's argument—and indeed with its present attempt to impose a market-based approach on petitioner's transactions—is that FERC does not, and apparently cannot, explain how OPCO can recover in its rates such a fair market value in excess of cost without running afoul of the SEC's bar in 17 C.F.R. § 250.90(a)(2). *See supra* p. 4. In other words, if we adopt FERC's approach, OPCO faces a tails-we-lose situation when FERC finds that fair market value dictates a captive coal level cost but is prevented by SEC regulation from winning when the other side of the coin comes up. Therefore, attractive as FERC's market approach may be in general, its application to the PUHCA-regulated petitioner adds nothing to FERC's argument in the present case.

III. Conclusion

For the reasons given above, we vacate and remand the decision of FERC. We would like to clarify that there are two issues which we do not address. First, we

do not hold that OPCO and SOCCO or any other SEC-regulated companies are entitled to pay and receive a price in excess of market. *See* 17 C.F.R. § 250.92. Second, we do not hold that FERC may not apply a market test to contracts between related companies that are subject to its jurisdiction but not that of the SEC. *See Public Serv. Co. of N.M.*, 832 F.2d at 1201. We hold only that the statute commits to the SEC such determinations regarding companies associated with a public utility holding company. Basing our decision as we do on this threshold issue, we have no occasion to reach the further issues raised by the petition.

Granted.

MIKVA, Circuit Judge, concurring:

I fully agree with my colleagues that the Federal Energy Regulatory Commission ("FERC") may not escape the strictures of section 318 of the Federal Power Act ("FPA"), 16 U.S.C. § 825q, simply by claiming that it and the Securities and Exchange Commission ("SEC") are not regulating "the same subject matter," for it is clear that both agencies have ruled on the price of coal between Ohio Power Company ("Ohio Power") and its subsidiary, Southern Ohio Coal Company ("Southern Ohio"). *See* Majority Opinion ("Maj. Op.") at 1405-1408.

In my view, however, for section 318 to divest FERC of jurisdiction, a person must also be subject to *conflicting* requirements of the Public Utility Holding Company Act ("PUHCA"), 15 U.S.C. §§ 79 *et seq.*, and the FPA. I base this conclusion not only on the text of the statute, but also because section 13 would otherwise serve no purpose. Applying this interpretation to the case *sub judice*, I am not convinced that the SEC's orders (under the PUHCA) and FERC's decision (under the FPA) are in conflict. Accordingly, I would uphold FERC's determination that section 318 does not bar its jurisdiction in this case.

I concur in the judgment of my colleagues, however, and would grant the petetion for review, on the alternate ground that FERC's decision is contrary to section 35.14 (a)(7) of its own regulations, 18 C.F.R. § 35.14(a)(7).

I.

Section 318 of the FPA provides in relevant part:

> If, with respect to the issue, sale, or guaranty of a security, * * * or the acquisition or disposition of any security, capital assets, facilities, or *any other subject matter*, any person is *subject both to a requirement* of the Public Utility Holding Company Act of 1935 * * * *and to a requirement* of this chapter * * *, the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this chapter * * * *with respect to the same subject matter*, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this chapter shall apply to such person.

16 U.S.C. § 825q (emphasis added). As I parse this provision, there is a jurisdictional conflict (and FERC must yield jurisdiction to the SEC) if, and only if, a person is subject to a conflicting "requirement" of both PUHCA and the FPA, and the requirements are "with respect to the same subject matter." The first condition is a logical necessity, for even if there is dual jurisdiction over "the same subject matter" (the second condition), if there is no conflict, then there is no need for FERC to yield to the SEC.

As noted above, I agree with my colleagues that the second condition has been met in this case: FERC and the SEC are clearly regulating the same subject matter, namely, the price of coal between Ohio Power and Southern Ohio. I am not so sure, however, that there is a conflict between the relevant SEC orders and FERC's decision below.

In 1971, the SEC (pursuant to the PUHCA) authorized the formation of Southern Ohio on the condition, *inter alia*, that "[t]he charges for coal by Southern Ohio will be *based on an amount equal to the actual cost* of Southern Ohio in developing the reserve and mining such coal, * * *." Ohio Power Co., Release No. 17,383, at 2 (Dec. 2, 1971) (SEC) (emphasis added). In its 1978 order approving the transfer of certain mine and other coal properties from Ohio Power to Southern Ohio, the SEC further stated that "[t]he price at which SOhio coal is sold to AEP System companies *will not exceed the cost thereof* to the seller." Ohio Power Co., Release No. 20,515, 14 SEC Docket 928, 929 (Apr. 24, 1978) (emphasis added).

In the decision below, FERC (pursuant to the FPA) ruled that, based on the market price for comparable coal, the price Ohio Power paid for Southern Ohio coal was unreasonably high; FERC therefore disallowed Ohio Power's request for a rate increase based on those costs. 39 FERC ¶ 61,098, at 61,285-86 (1987), *reh'g denied*, 43 FERC ¶ 61,046 (1988).

In this petition, Ohio Power maintains that there is a jurisdictional conflict by arguing (and, incidentally, implicitly conceding that section 318 requires a conflict) that section 13(b) of the PUHCA, 15 U.S.C. § 79m(b), mandates a cost standard and that, in any event, the SEC in this case required Southern Ohio to set its price at cost. I disagree.

Although section 13(b) includes the phrase "at cost," Congress intended section 13(b) to avoid "*excessive* charges" resulting from the lack of arm's-length bargaining and open competition between public utility holding companies and their subsidiaries. PUHCA § 1(b)(2)

(emphasis added), 15 U.S.C. § 79a(b)(2); *see also North American Co. v. SEC*, 327 U.S. 686, 701 & n. 11, 66 S.Ct. 785, 794 & n. 11, 90 L.Ed. 945 (1946) (citing congressional findings underlying section 1(b)). The SEC has interpreted section 13(b) to mean that "[n]o subsidiary company of a registered holding company * * * shall perform any service or construction for, or sell any goods to, any associate company therefore, or enter into any contract to do so, at *more than cost* * * *." 17 C.F.R. § 250.90(a)(2) (emphasis added). Indeed, the SEC even permits a market-price test for the sale of goods between such affiliates. *See* 17 C.F.R. § 250.92(b). I cannot conclude that section 13(b) necessarily mandates strict at-cost pricing between public utility holding companies and their associates.

Ohio Power also argues that, in any event, the SEC did not authorize a market approach in this case. But this argument is misplaced, for the issue is whether there is a conflict in requirements under the two statutes. Because the SEC in 1978 limited the price of coal only to *cost as a ceiling*, *see* Ohio Power Co., Release No. 20515, 14 SEC Docket 928, 929 (Apr. 24, 1978), I find no conflict between that requirement and FERC's requirement that Ohio Power pay market price, where, as in this case, the market price is less than cost. The SEC's 1971 order is not to the contrary, for it requires only that the price be "based on" cost; the later order imposing cost as a ceiling is certainly "based on" cost.

Moreover, as my colleagues note, *see* Maj. Op. at 1408-09, the SEC's approval of the various transactions was grounded on the financial aspects of the corporate arrangements, not on the reasonableness of the price paid for the coal. Ohio Power therefore reads too much into the SEC orders when it claims that the SEC expressly conditioned its approval of the affiliate arrangement on a strict cost-based standard—Ohio Power relies too heavily on what seems to be merely boilerplate language. Accordingly, because I read the SEC's orders to permit Ohio Power to pay less than cost for the coal, FERC's imposition of a market price less than cost does not in this case create a jurisdictional conflict. As FERC stated below: "it is not clear that the SEC requires Ohio Power to purchase coal from its subsidiary at cost, rather than at market price. The SEC orders which Ohio Power cites for this proposition * * * do not appear to mandate the cost-based price where a market price would be lower, rather they permit a price up to a cost-based price." 39 FERC at 61,276.

In short, although Ohio Power has met the second condition of section 318 (both agencies are regulating the "same subject matter," namely, the reasonableness of the price paid), it has not met the first. Under the facts of this case, the SEC has not precluded a price *less than* cost; FERC's setting of the allowable price at a market price less than cost therefore does not create a conflict that would bring section 318 into play.

I note in passing that, under my view, if FERC had sought to impose a price *higher than* cost (i.e., if the market price determined by FERC were higher than cost), then FERC's requirement would clearly conflict with the SEC's requirement and, under section 318, FERC would have to abide by the SEC's determination. This implies that, in a case where the SEC has set cost as a ceiling, FERC has jurisdiction to impose a market price only if that price is less than cost. FERC in dictum below, however, would have permitted Ohio Power to recover the market price even if that price exceeded cost. *See* 39 FERC at 61,287-88. Although this is a problematic aspect of the decision below, we need not pass on its validity under section 318, for that case is simply not before us today.

II.

Ohio Power argues in the alternative that, even if section 318 does not apply, section 35.14(a)(7) of

FERC's own rules bars it from imposing its market-price test. I would agree and grant the petition on this ground.

Section 35.14(a)(7), which governs fuel price adjustment clauses in filed rate schedules, provides in pertinent part:

> Where a utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, *such cost shall be deemed to be reasonable* and includable in the adjustment clause.

18 C.F.R. § 35.14(a)(7) (emphasis added). There is no dispute that this rule applies to the transaction in this case; the only issue on appeal is the meaning of the word "deemed." FERC, affirming the administrative law judge on this point, found that the regulation creates only a rebuttable presumption of reasonableness. *See* 39 FERC at 61,287-88. Ohio Power challenges this conclusion, arguing that the word "deemed" establishes instead a conclusive presumption.

The applicable standard of review is clear. Although a reviewing court must defer to an agency's interpretation of its own rules, *see Western Union Telegraph Co. v. FCC*, 815 F.2d 1495, 1503 (D.C. Cir. 1987), no deference is owed an interpretation at odds with the plain meaning of the text, *see Union of Concerned Scientists v. NRC*, 711 F.2d 370, 381 (D.C. Cir. 1983) ("When an agency's interpretation flies in the face of the language of the rules themselves, it is owed no deference.").

Although the provision at issue has apparently not been interpreted in any published opinion, courts construing the word "deemed" have generally found that it establishes a conclusive presumption. *See H.P. Coffee Co. v. Reconstruction Finance Corp.*, 215 F.2d 818, 822 (Emer. Ct. App. 1954) (finding "almost unanimous judicial determination that the word ['deemed'], when employed in

statutory law, creates a conclusive presumption") (citing cases); *see also Dameron v. Brodhead*, 345 U.S. 322, 326-27, 73 S.Ct. 721, 723-24, 97 L.Ed. 1041 (1953) (rejecting, in a case involving state taxation of a serviceman's personal property, the argument that "deemed" implies a rebuttable presumption, because such a construction would nullify the statute); *Kyzar v. Califano*, 597 F.2d 68, 71 (5th Cir. 1979) (where statute provided that an insured child is "deemed dependent" upon a stepparent if the child was living with the stepparent at the time of death of the natural parent, Congress intended that dependency would be conclusively established upon proof of the objective criteria); *Kohn v. Myers*, 266 F.2d 353, 357 (2d Cir. 1959) ("The word 'deemed' gives rise to a conclusive presumption or substantive rule of law that the acquisition of assets from a bankrupt after a petition of bankruptcy is filed is not in good faith if the transferee knew the petition was pending and did not have reasonable cause to believe that it was not well founded."). Numerous state court decisions, too many to list here, are in accord.

Moreover, if the intent of the regulation were to create a rebuttable presumption, as FERC now contends, then the rule would be superfluous, for it has long been settled that a utility's costs are presumed (subject to rebuttal) to be prudently incurred. *See Missouri ex rel. Southwestern Bell Telephone Co. v. Missouri Pub. Serv. Comm.*, 262 U.S. 276, 289 n. 1, 43 S.Ct. 544, 547 n. 1, 67 L.Ed. 981 (1923); *Anaheim v. FERC*, 669 F.2d 799, 809 (D.C. Cir. 1981).

The history of section 35.14(a)(7) also supports Ohio Power's reading of the provision, for FERC has twice proposed and rejected a different rule to accomplish the result that it now claims flows from the existing rule. First, as originally proposed by the Federal Power Commission ("FPC") in 1973, the regulation did not contain the "deemed" language:

> Where the cost of fuel includes fuel from company owned or controlled sources, that fact shall be noted and described as part of any filing. *Only the reasonable cost of such fuel may be included. Amounts collected from customers in excess of such reasonable cost shall be subject to refund.*

38 Fed. Reg. 17,253 (1973) (emphasis added). Only the unitalicized sentence has been retained in the current regulation. After public comment, the second and third sentences were modified to its current version:

> Where the cost of fuel includes fuel from company-owned or controlled sources, that fact shall be noted and described as part of any filing. *Where the utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed reasonable and includable in the adjustment clause.* * * * Fuel charges which do not appear to be reasonable may result in the suspension of the fuel adjustment clause or cause an investigation thereof to be made by the Commission on its own motion under section 206 of the Federal Power Act.

39 Fed. Reg. 28,911 (1974) (emphasis added). When the rule was eventually promulgated, the FPC explained that "[t]he modification provide[s] that when a utility purchases fuel from an owned or controlled source and the price is subject to the jurisdiction of a regulatory body, the cost of the fuel *may be included* in the fuel adjustment clause." 39 Fed. Reg. 40,583 (1974) (emphasis added). The addition of the "deemed" language suggests, albeit weakly, that the prior version, which was rejected and which provided no special treatment for affiliate fuel purchases subject to the jurisdiction of another regulatory body, would have accomplished the result FERC now seeks to impose.

Second, in 1979 FERC proposed to amend section 35.14(a)(7) to require utilities to file, as rate schedules,

all contracts for fuel purchases from company-owned or company-controlled sources, regardless of whether the price was subject to the jurisdiction of a regulatory body. *See* 44 Fed. Reg. 28,683 (1979). The stated purpose of this proposal was "to further aid the Commission in fulfilling its responsibility to ensure that utilities are purchasing fuel at reasonable prices and that only allowable costs are being passed through in the fuel cost adjustment clause." *Id.* at 28,684; *see also* 45 Fed. Reg. 82,272 (1980). Although FERC later determined that its adoption of a market-price test for determining the reasonableness of affiliate fuel costs made the proposed revision unnecessary, *see* 50 Fed. Reg. 24,779 (1985), it is significant that FERC's proposal would have been superfluous had the provision already established merely a rebuttable presumption of reasonableness, because there would have been no question that FERC would have had independent jurisdiction to review the contracts.

FERC relies heavily on an interpretation of the section in a 1975 FPC chairman's letter to a Senate Subcommittee, but that letter is not persuasive. The letter merely states that section 35.14(a)(7) creates "a presumption of reasonableness" without specifying whether the presumption is rebuttable or conclusive. *The Utility Act of 1975: Hearings on S. 594 Before the Subcomm. on Intergovernmental Relations, Senate Comm. on Government Operations*, 94th Cong., 1st Sess. 500, 514 (1975).

Finally, FERC argues that its statutory mandate to ensure that rates are just and reasonable implies that section 35.14(a)(7) cannot be read to foreclose FERC from independently determining the reasonableness of wholesale utility charges. But this argument is valid only if one ignores section 35.14(a)(7). Although, as a general matter, FERC may have the authority to make an independent determination of reasonableness, section 35.14(a)(7) forecloses such a route to the extent that

the price is already subject to the jurisdiction of another regulatory body. In other words, section 35.14(a)(7) establishes, as a policy matter, that if another regulatory body has already passed on the fuel price, then FERC will abide by that determination. This reading is entirely consistent with the purpose of section 35.14(a)(7), which is to avoid unreasonable fuel costs between affiliated companies, for if another agency (e.g., the SEC) has already made that determination, then there is no reason for FERC to second-guess that decision.

* * * *

I concur with my colleagues that the petition for review should be granted, but not on the basis of section 318 of the FPA. I do not find, in this case, a collision between the two agencies operating in this field. Rather, I would find that FERC erroneously construed section 35.14(a)(7) of its regulations to establish merely a rebuttable presumption of reasonableness. Under the regulation, because the prices of Ohio Power's fuel from its affiliate are subject to the jurisdiction of the SEC, such costs must be conclusively presumed reasonable.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 88-1293

OHIO POWER COMPANY,
Petitioner,
v.
FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,
OHIO MUNICIPALS,
Intervenors.

Before: MIKVA, SILBERMAN and SENTELLE, Circuit Judges

ORDER

[Filed Oct. 12, 1989]

Upon consideration of the Petitions For Rehearing of Respondent Federal Energy Regulatory Commission and Intervenor Ohio Municipals, it is

ORDERED, by the Court, that the petitions are denied.

Per Curiam

FOR THE COURT:

CONSTANCE L. DUPRE
Clerk

By: s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

Circuit Judge Mikva would grant the petitions for rehearing. His statement is attached.

Statement of MIKVA, Circuit Judge

I would grant the petition for rehearing by the panel. I continue to be concerned that the panel opinion creates a regulatory gap that can be mischievous in future cases. As I state in my concurring opinion when the case was originally heard, there is no conflicting requirement imposed by the agencies involved with respect to the same subject matter. Accordingly, the Federal Energy Regulatory Commission (FERC) was not ousted of its jurisdiction over the price of coal charged to Ohio Power Company. The flaw in FERC's decision stems from a fatal conflict with its own regulations, and warrants granting the petition for review, as the panel decision ordained. The statutory interpretation engaged in by the majority, however, generates a no-man's land where neither the Securities and Exchange Commission (SEC) nor FERC will patrol holding company practices which can oppress consumers, investors and the public. Congress did not intend and our court should not construct such a result.

Because the result in the instant petition would not be affected by my interpretation of the relevant statutes, I do not call for a rehearing by our full court. I do continue to express a concern about what I perceive to be a flawed parsing of the statutes involved in this important and delicate area of interagency administration of the law.

APPENDIX C

FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. ER82-553-000 and ER82-554-000

OHIO POWER COMPANY

Opinion No. 272; Opinion and Order on Recovery of the Cost of Coal Purchased From an Affiliate

(Issued April 30, 1987)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

[Note: Initial Decision of the presiding administrative law judge, issued December 14, 1983, appears at 25 FERC ¶ 63,060.]

Appearances

Edward J. Brady, Marvin I. Resnick, Alan Kessler, and *William E. Olson* for Ohio Power Company

William H. Roberts and *Richard Hitt* for Public Service Commission of West Virginia

Paul Nordstrom, Glen L. Ortman, Kenneth E. Natale, Donald R. Allen, David P. Yaffe, and *Gregg D. Ottinger* for the Municipal Wholesale Electric Customers of Ohio Power Company

Phillip Nelson and *O.C. Hall* for Wheeling Electric Company

James D. Kauffelt for Linden Chemicals and Plastic, Inc., Mobay Chemical Corporation, and PPG Industrials, Inc.

Melvin Berger, Arthur Hays Butler, Lawrence R. Greenfield, Michael Small, James E. Rogers, Jr., Marilyn L. Doria, Harvey L. Reiter and *Daniel Watkiss* for the staff of the Federal Energy Regulatory Commission

[Opinion No. 272 Text]

I. Introduction and Summary

On May 28, 1982, the Ohio Power Company (Ohio Power) filed rate increases for its wholesale service to fifteen municipalities in the State of Ohio (Docket No. ER82-553-000) and to its affiliate in West Virginia, the Wheeling Electric Company (Docket No. ER82-554-000). The Commission accepted settlements dealing with all aspects of the proposed rates except what was called the captive coal issue which involves a challenge to the reasonableness of the fuel costs recovered from Ohio Power's wholesale customers for the coal it purchased from the Martinka mine.[1]

The Martinka mine is owned and operated by the Southern Ohio Coal Company, a wholly owned subsidiary of Ohio Power. Ohio Power is owned by the American Electric Power Company (AEP). AEP owns seven other electric utilities that operate as a coordinated system in a seven-state area. AEP is subject to regulation by the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (PUHCA).[2]

An initial decision on the reasonableness of Ohio Power's coal costs was issued on December 14, 1983.[3] In the initial decision the presiding judge found that:

(1) section 318 of the Federal Power Act does not preclude the Commission from determining whether it is just and reasonable for Ohio Power to recover the full cost of its purchases from the Martinka mine from its wholesale ratepayers;

(2) the Commission's fuel adjustment clause regulation[4] creates only a presumption which does not preclude the Commission from considering the reasonableness of Ohio Power's fuel costs;

(3) Ohio Power's coal costs are subject to a comparable market price test as adopted in Opinion No. 133[5] to determine the reasonableness of those costs; and

(4) the comparable market price evidence presented to show that Ohio Power's costs were not reasonable was not credible.

The judge concluded that the prices paid by Ohio Power for Martinka coal were reasonable.

Briefs on exceptions to the initial decision and briefs opposing exceptions were filed by Ohio Power, Commission trial staff (staff), and the Municipal Wholesale Electric Consumers of Ohio Power (the municipals).[6]

Ohio Power excepts to the judge's ruling on the preemptive effect of section 318 of the Federal Power Act and section 35.14(a)(7) of the Commission's regulations on the Commission's review of Ohio Power's coal costs.

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[1] *See Ohio Power Company*, 23 FERC ¶ 61,236 (1983) and 24 FERC ¶ 61,017 (1983).

[2] 15 U.S.C. § 79a (1982).

[3] 25 FERC ¶ 63,060 (1983).

[4] 18 C.F.R. §35.14(a)(7) (1986).

[5] *Public Service Company of New Mexico (New Mexico)*, 17 FERC ¶ 61,123 (1981), *appeal pending sub nom. Public Service Company of New Mexico v. F.E.R.C.*, Nos. 82-1148, 84-1624 and 84-1677 (10th Cir., filed Feb. 3, 1982).

[6] On May 15, 1986, New England Power Company (NEP) filed a motion with the Commission for permission to file an *amicus curiae* brief in this proceeding; our staff, the municipals, the Town of Norwood, Massachusetts, the Attorney General of Rhode Island, and the Rhode Island Division of Public Utilities and Carriers oppose NEP's motion. Because of the lateness of the filing without good cause the Commission shall deny the motion.

Ohio Power argues that the Commission can change its regulations only prospectively. Ohio Power also objects to the imposition of a comparable market price test on a utility subject to PUHCA asserting that the result would be a lower of cost or market price test, a result which Ohio Power asserts would be confiscatory. Ohio Power further urges that as a factual matter Ohio Power's ownership of affiliate mines serves the purpose of delivering the lowest priced electricity possible. Staff and the municipals except to the judge's rejection of staff's evidence as a reliable determinant of comparable market prices.

We affirm the judge's rulings and reasoning regarding the Commission's authority, pursuant to the Federal Power Act and our regulations, to determine the reasonableness of coal costs Ohio Power recovers from its wholesale customers. We disagree, however, with the judge's finding that those costs were reasonable. We find the costs Ohio Power has recovered for its purchases of Martinka coal are unreasonable when compared with market prices and that Ohio Power therefore must refund amounts collected since the effective date of the rates in this proceeding that exceed the comparable market price.

II. Discussion

A. Commission Jurisdiction to Review Ohio Power's Coal Costs

1. Section 318 of the Federal Power Act

Ohio Power urges that under PUHCA and section 318 of the Federal Power Act, the SEC has exclusive jurisdiction over the pricing of the affiliate Martinka coal.[7] The presiding judge concluded that section 318 of the Federal Power Act[8] does not preclude this Commission

[7] Ohio Power brief on exceptions at 17-36.

[8] 16 U.S.C. § 825q (1982).

from determining whether it is just and reasonable for Ohio Power to recover from its wholesale cutomers, in its rates, the full cost of its purchases from the Martinka mine.[9]

The source of the SEC's authority to regulate the price at which Ohio Power purchases coal from its subsidiary is section 13 of PUHCA.[10] Ohio Power contends that section 13(b) of PUHCA mandates that it purchase coal from its subsidiary at cost.[11] Ohio Power contends that if the Commission orders that Ohio Power may recover in rates only a market-based amount for the Martinka coal, that Ohio Power will face conflicting regulation by the SEC and the Commission which is prohibited by section 318 of the Federal Power Act. Section 318 provides:

> If, with respect to the issue, sale, or guaranty of a security . . . , *or any other subject matter*, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 . . . and to a requirement of this Act . . . the requirement of the Public Utility Holding Company Act of 1935 shall

[9] 25 FERC at p. 65,183.

[10] 15 U.S.C. § 79m (1982).

[11] The relevant portions of section 13(b) of PUHCA, 15 U.S.C. § 79m(b) (1982), provide:

> [I]t shall be unlawful for any subsidiary company of any registered holding company or for any mutual service company . . . to enter into or take any step in the performance of any service, sales, or construction contract by which such company undertakes to perform services or construction work for, or sell goods to, any associate company thereof except in accordance with such terms and conditions and subject to such limitations and prohibitions as the [Securities and Exchange] Commission by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies.

> apply to such person, and such person shall not be subject to the requirement of this Act . . . *with respect to the same subject matter*, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this Act shall apply to such person. (Emphasis supplied.)

The judge concluded that, assuming the SEC set the price at which Ohio Power may purchase its subsidiary's coal, there was no conflict of jurisdiction because the SEC regulates the intra-corporate price of coal between Ohio Power and its subsidiary, while this Commission sets rates.[12] The judge concluded that the same subject matter is not subject to the requirements of both PUHCA and the Federal Power Act.[13] We agree with the judge.

First, it is not clear that the SEC requires Ohio Power to purchase coal from its subsidiary at cost, rather than at market price. The SEC orders which Ohio Power cites for this proposition state that the charges for the coal "will be based on actual cost," [14] and "will not exceed the cost thereof to seller." [15] These orders authorized financing for the coal mining subsidiary. They do not appear to mandate the cost-based price where a market price would be lower, rather they permit a price up to a cost-based price.

The SEC's Rule 92 implements in part section 13 of PUHCA. The rule prohibits a subsidiary of a registered holding company from selling

> any goods produced by it to any associate company thereof, or enter into any contract to do so, at a

[12] 25 FERC at p. 65,183.

[13] *Id.*

[14] SEC 1935 Act Release No. 17383, Dec. 2, 1971.

[15] SEC 1935 Act Release No. 21537, April 25, 1980.

> price which exceeds the price at which the purchasers might reasonably be expected to obtain comparable goods elsewhere, or to finish them itself, giving due regard to quality, quantity, regularity of supply, and other factors entering into the calculation of a fair price.[16]

Thus it appears that not only does the SEC not require a cost-based price for the subsidiary coal, the SEC may require a market-based price for subsidiary coal if the market price is lower than cost.[17]

More importantly, assuming that the SEC has actually affirmatively set the price which Ohio Power must pay its subsidiary for the Martinka coal, setting the intra-corporate price and setting rates are not the same subject matter which would bring section 318 into play. We have taken full account of the fact that the SEC has jurisdiction, under PUHCA, to regulate the price of coal purchased by Ohio Power from the Martinka mine. The SEC's jurisdiction, however, does not extend to setting rates and determining what fuel costs Ohio Power may collect from its wholesale customers. There is thus no

[16] 17 C.F.R. § 250.92 (1986).

[17] The SEC can, pursuant to section 13(b), authorize a market-based price for a transaction between a subsidiary and parent even when that market-based price exceeds cost. *See*, New England Electric System, 1935 Act Release No. 22309, 24 SEC Docket (1981), where the SEC, pursuant to the provisions of section 13(b), exempted a contract from the cost limitation of 13(b) so that a market-based approach could be used. Thus Ohio Power could apply to the SEC for approval of a market-based pricing mechanism for its affiliate coal if it so desired. *See also*, "Comment of the Division of Corporate Regulation of the Securities and Exchange Commission on the Federal Energy Regulatory Commission Staff Preliminary Report of Investigation in FERC Docket No. E-9206 dated July 31, 1978" filed in Docket No. E-9206, on October 27, 1978, at 3. Therefore as a factual matter, it does not appear that Ohio Power is accurate in stating that a company subject to SEC jurisdiction pursuant to PUHCA is required always to sell its products to an affiliate at cost-based prices.

conflict in the regulation by the SEC and the regulation by this Commission.[18]

The SEC's Division of Corporate Regulation submitted comments in another Commission case involving AEP affiliate coal purchases in which staff of the SEC explained its view of the effect of SEC orders approving the financing of coal mining subsidiaries under PUHCA.[19] These comments demonstrate that the SEC recognizes that it does not set rates:

> The orders of the SEC under the 1935 Act do not set rates for operating utility companies. There is no conflict with FERC jurisdiction. In setting rates, FERC is legally bound to give due consideration to cost of service, which certainly includes cost of fuel burned, but there are a number of intermediary steps between our order authorizing an affiliate to acquire and mine coal reserves and the rate determination . . . .
>
> The SEC pricing orders are final orders directed, in conjunction with the 1935 Act and the pertinent rules, to fixing a pricing formula until further order of the Commission. It is the rate making authority,

[18] *See Mississippi Industries v. F.E.R.C.*, 808 F.2d 1525, 1550-51 (D.C. Cir. 1987). Appalachian Power Company, another AEP owned utility, raised the same contention regarding SEC regulation in *McDowell County Consumers Council, Inc. v. American Electric Power (McDowell County)*, Docket No. E-9206. The Commission, in setting AEP's coal purchasing practices for investigation, responded that its investigation was "instituted for the purpose of fulfilling this Commission's statutory obligation as expressed in Sections 202, 205, 206, 301, 306, 307 and 309 of the Federal Power Act which are in no way repugnant to the exercise of any authority which the SEC may choose to assert under its statute." *See* 54 FPC 361, 363 (1975).

[19] "Comment of the Division of Corporate Regulation of the Securities and Exchange Commission on the Federal Energy Regulatory Commission Staff Preliminary Report of Investigation in FERC Docket No. E-9206, dated July 31, 1978."

> not the SEC, that has jurisdiction to try issues, both of fact and of interpretation, in applying such orders, insofar as material, to a particular rate case.

Moreover, the SEC itself, as opposed to its staff, has recognized that its regulation of fuel-related costs, pursuant to section 13(b), is not in conflict with and does not preclude this Commission setting rates. In *New England Electric System* the SEC authorized a joint venture in which a registered holding company and two of its subsidiaries would participate in building a coal-fired collier. The SEC, pursuant to section 13(b), exempted the transaction from the cost limitations of 13(b), so that the transportation approved by the SEC was at a market-based price which was expected to exceed cost. The SEC commented on the relationship of its regulation under section 13(b) of PUHCA and this Commission's rate regulation:

> We cannot assess now, when the vessel is under construction, the extent to which the price to be determined under the charter will exceed cost under Section 13(b). Nor are we inclined to reserve jurisdiction over the adjustments and redefinitions under the charter as they develop over the next quarter century. The charter with NEPCO has other regulatory effects, not under the Act we administer, that in this case better serve the purpose and allay our concern.

NEPCO is engaged in the production, transmission and sale, at wholesale, of electric energy, essentially to the utility associate companies in the NEES system. It is a public-utility as defined in section 201(e) of the Federal Power Act and its rates are subject to FERC jurisdiction under section 206 thereof. The rates allowed to NEPCO include, as a cost of service, its cost of fuel, which as allowed to NEPCO may include either the entire cost of transportation under the joint venture's charter to NEPCO, if FERC

should determine that it is just and reasonable, or some other amount.

Our grant of the exemption does not affect FERC's authority over rates; and the bilateral arrangement under the charter following upon the exemption does not prescribe what should be allowed to NEPCO in revenues from its wholesale power customers for transportation costs, either in allowed rates or under the fuel adjustment clause. These adjusting effects provide us sufficient assurance to determine that the exemption from cost remains consistent with the policy of section 13(b). In relying on this ratemaking process we do not cede any of our statutory responsibilities to another agency.[20]

We believe that the SEC's analysis that its determination pursuant to section 13(b) of PUHCA does not affect our authority to make rate determinations is in accord with the presiding judge's conclusion that the SEC's regulation pursuant to section 13(b) of PUHCA does not preclude this Commission from determining the reasonableness of Ohio Power's coal costs during the ratemaking process. We shall affirm the judge's determination on this issue.

2. Section 35.14(a)(7) of the Commission's Regulations

Ohio Power contends that section 35.14(a)(7) of our regulations[21] precludes this Commission from looking at the price of the Martinka coal because that coal is subject to SEC and Ohio PUC regulation. Section 35.14(a)(7) provides in part that "where a utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and

[20] 24 SEC Docket at 307-08.

[21] 18 C.F.R. § 35.14(a)(7) (1986).

includable in the adjustment clause." Ohio Power argues that we cannot change the regulation without notice to those affected.[22]

The judge concluded that section 35.14(a)(7) creates a rebuttable presumption of reasonableness.[23] We agree. As the judge noted, in 1975, six months after promulgation of section 35.14(a)(7), the Chairman of the Federal Power Commission submitted a letter to the Senate Subcommittee on Reports, Accounting and Management, stating that section 35.14(a)(7) creates a presumption of reasonableness, not a conclusive finding of reasonableness. There is thus no retroactive change of a regulation involved in this case.[24]

B. Determining the Reasonableness of Ohio Power's Affiliate Fuel Purchases

Prior to Opinion No. 133 the reasonableness of affiliate coal purchases were determined on a cost-of-service basis.

[22] Ohio Power brief on exceptions at 57.

[23] 25 FERC at p. 65,184.

[24] ABP, and its affiliates, had actual notice of the Commission's belief that section 35.14(a)(7) of its regulations does not preclude a comparable market-price investigation into its affiliate coal purchases. The same issue was involved in *McDowell County*. Eight months after promulgation of section 35.14(a)(7), the Commission instituted an investigation of AEP's coal purchasing practices, including its purchases from affiliate coal companies which were subject to SEC regulation. 54 FPC 361 (1975). The Commission ordered that the investigation "include all coal contracts whether or not required to be submitted pursuant to Commission Order No. 517, 52 FPC 1304," the order promulgating section 35.14(a)(7). The Commission later ordered hearings on the coal cost issue pursuant to sections 205 and 206 of the Federal Power Act. 15 FERC ¶ 61,257, at p. 61,592-93 (1981).

Moreover, the SEC had made its determination before this proceeding was set for hearing at this Commission. Had the Commission considered the SEC determination to be conclusive, as Ohio Power contends, the issue of Ohio Power's coal costs would not have been set for hearing.

Under the Commission's regulation at section 35.14(a)(7), affiliate coal purchases which were subject to the regulation of another agency were deemed to be reasonable. If the affiliate transactions were not subject to the regulation of another agency, the utility was required to justify the reasonableness of the cost of the affiliate coal.

In Opinion No. 133, the Commission tested the reasonableness of prices of affiliate coal purchases by comparing them to prices available from non-affiliated suppliers in a competitive market. The Commission found that "the interests of consumers will best be protected by permitting utilities that purchase coal from affiliates to recover no more from their ratepayers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier." [25]

Although the Federal Power Act does not mandate a market-price test to determine the reasonableness of affiliate transactions, there is no legal impediment to the use of such a test,[26] and there are a number of reasons arguing for its use. The Commission noted in Opinion No. 133 that companies that are subject to the competitive market are more efficient and innovative than those assured of a recovery of costs and a reasonable return, and that a market-price limitation on fuel expense recovery from affiliated suppliers provides the best incentive for utilities to develop the least costly sources of fuel.[27] In addition to the economic efficiency promoted by a market-price test, it provides protection from the prospect of self-dealing that arises in transactions between affiliates.

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[25] 17 FERC at p. 61,246.

[26] It is noteworthy that the Natural Gas Policy Act, 15 U.S.C. §§ 3311-3432 (1982) establishes the comparable market price as the ceiling for a just and reasonable amount a pipeline may pay an affiliated producer for gas. *See* section 601(b)(1)(E), 15 U.S.C. § 3431(b)(1)(E) (1982).

[27] 17 FERC at p. 61,246.

What the Commission noted in stating the purpose of the comparable market-price test required by the Natural Gas Policy Act, for transactions between pipeline affiliates, is equally applicable to purchases from affiliates by electric utilities: "At the heart of section 601(b)(1)(E) is the simple notion that a pipeline may not grant a price preference to its affiliate." [28] In a *New Mexico* proceeding subsequent to Opinion No. 133, the Commission characterized the comparable market-price test as "an objective test" that prevents rate manipulation.[29] It provides a substitute for the arms-length negotiations that provide objectivity and fair dealing in non-affiliate transactions.

The Commission has not deviated from its continued support for a market-price test. As recently as 1985 the Commission reaffirmed its departure from a cost-based test of reasonableness for affiliate transactions. The enunciation of the market-price test in Opinion No. 133 was given by the Commission as its reason for terminating a 1979 rulemaking that had proposed to amend section 35.14(a)(7) to delete the provision deeming reasonable coal costs that were subject to the jurisdiction of another regulatory agency and to require that utilities file affiliate coal contracts regardless of jurisdiction by another agency.[30] The Commission, noting that the amendment to its regulations was proposed to effect the cost-based policy in effect when the proposal was issued,

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[28] *El Paso Natural Gas Company*, 23 FERC ¶ 61,216, at p. 61,449 (1983).

[29] Opinion No. 164, 23 FERC ¶ 61,218, at p. 61,457 (1983).

[30] Termination of Rulemaking Dockets, 50 Fed. Reg. 24,779 (June 13, 1985), *FERC Statutes and Regulations, Proposed Regulations 1977-1981* ¶ 32,409, at p. 33,169; Revision of Fuel Cost Adjustment Clause Regulations Relating to Fuel Purchases from Company-Owned or Company-Controlled Sources, 44 Fed. Reg. 28,683 (May 16, 1979), *FERC Statutes and Regulations, Proposed Regulations 1977-81* ¶ 32,022.

found that the filing of contracts was no longer necessary because of the departure from that policy and the adoption of a market-price test.[31]

Under a market-price test, the question in this proceeding is whether the price at which Ohio Power purchased Martinka coal from its affiliate is reasonable when compared with prices in the market for alternative supplies.

1. Establishing Comparable Market Prices

To establish a benchmark market price, staff identified other coal-fired electric generating plants within 50-, 75- and 100-mile radiuses of the Mitchell plant that use coal with sulfur content and Btu heat content comparable to that used at Mitchell,[32] and calculated the weighted average prices of contract coal delivered to those plants. The prices were taken from FERC Form 423 and were increased by 3.1%.[33]

The prices compared are the delivered prices, thus including the costs of transportation. Staff's study shows that there are no significant differences between the weighted average cost of comparable coal delivered within

[31] *FERC Statutes and Regulations, Proposed Regulations 1977-1981* ¶ 32,409, at p. 33,169.

[32] *See, e.g.*, Ex. 13, Ex. 15 at 13-22, Tr. at 992-93. There is a high concentration of coal-fired electric plants in the vicinity of the Mitchell plant.

[33] Form 423 was designed to collect data on the cost and quality of fuel used for generating electricity. Among other things, the data facilitates comparison of the costs of captive and non-captive coal. *See* Change in Public Availability of FPC Form 423—Data on Cost and Quality of Fuels for Electric Plants, Docket No. RM77-2, 44 Fed. Reg. 21,596 (April 10, 1979), 6 FERC ¶ 61,208, at p. 61,520 (1979). The increase of 3.1% from the prices reported in Form 423 is based on a one-month audit by the Energy Information Administration of the Department of Energy which found that reporting utilities had understated their costs by this percentage.

50 miles of Mitchell and the cost of such coal delivered within the 75- and 100-mile radiuses. Staff ultimately relied, therefore, on prices within the 50-mile radius to establish the comparable market price. Within that radius, there were 13 plants which burned coal with a sulfur content of 1-4%, the range of sulfur content in the coal burned at Mitchell (including Martinka coal and other coal).

The average prices of the coal at the 13 plants in staff's study and the prices Ohio Power paid for Martinka coal are as follows:

	*Comparable Coal (1-4% sulfur)**	*Martinka Coal*	*Percentage Difference*
1980	123.2MMBtu	184.9¢/MMBtu	50%
1981	138.4	268.7	94%
1982	155.4	206.8	33%

* Adjusted up by 3.1% from Form 423 data.

(a) Characteristics of Comparable Coal

A comparable market price is the price of coal that is suitable for use at the plant in question, even if it is not identical to the coal from the affiliated supplier. If a certain characteristic of coal renders it unsuitable for use at a particular plant, it may nevertheless be suitable for purposes of price comparison, if the characteristic in question does not affect prices in the marketplace.

Staff limited its analysis of coal contracts to those for coal with heat content and sulfur content similar to that of coal now burned at the Mitchell plant because these are the two characteristics of coal that most significantly affect prices in the marketplace.[34] Ohio Power has established that coal with a high ash-fusion temperature is essential to the efficient operation of Mitchell Unit No. 2.[35] Martinka coal has such a characteristic.[36] However,

[34] Ex. 13 at 12.

[35] 25 FERC at p. 63,060, Ex. 4 at 17.

Ohio has not established that the ash-fusion temperature of Martinka coal commands a premium in the marketplace over coal with lower ash-fusion temperatures. It is therefore irrelevant for purposes of establishing comparable prices that the precise ash-fusion temperature of the coal included in staff's set of comparable contracts is unknown. We note however, that staff's evidence indicates that coal burned at neighboring plants with dry bottom boilers, such as Mitchell's, which generally require coal of higher ash-fusion temperature, does not command a price premium over coals burned at neighboring plants with wet bottom boilers.[37]

On the other hand, the captive coal may have characteristics that increase its price in the marketplace, but are not required for the boiler. The Mitchell plant was designed to burn coal with more than 4% sulfur content, and meet the emission standards of the Environmental Protection Agency.[38] Martinka coal has a sulfur content of approximately 1.5%.[39] The record in this case is clear that Ohio Power switched to Martinka coal in Mitchell Unit No. 2 because of its higher ash-fusion temperature, not because of its lower sulfur content.[40] Some of Ohio Power's witnesses suggest that the low sulfur content of Martinka coal renders it more desirable for environmental reasons than the non-affiliate coals with higher sulfur content also burned at Mitchell.[41] However,

[36] *Id.*

[37] We also note that it is clear from the record that coal with ash-fusion temperatures that met Ohio Power's bid specifications was available at prices lower than Ohio Power paid for the Martinka coal. *See* Section II.B.1.(e) of this Opinion.

[38] 25 FERC at p. 65,189, Ex. 3, at 10, Ex. 15 at 13.

[39] *See, e.g.*, 25 FERC at pp. 65,182, 65,189, Ex. 15kk at 12, Ex. 3 at 22, Ex. 15 at 6.

[40] *See, e.g.*, 25 FERC at p. 65,181, Ex. 4 at 17.

[41] *See, e.g.*, Ex. 4 at 15-21.

there is no evidence that it is required. Ohio Power's use of low sulfur coal at Mitchell appears to be fortuitous.

As described above, staff developed its benchmark price based on coals with 1-4% sulfur content from 13 plants. Of the 13 plants, eight plants used coal with a range of 1-2% sulfur content, comparable to the 1.5% sulfur content of Martinka coal.[42] If it were clear that there were no benefits from the use of low sulfur coal at the Mitchell plant, a proper sample would exclude coals with 1-2% sulfur content. It appears there are no appreciable benefits in terms of the efficiency of the boiler's operation. However, while the low sulfur coal is not required to meet environmental standards, there may be environmental benefits from its use. We find that the use of coals with 1-4% sulfur content is a reasonable compromise.

(b) Characteristics of Comparable Contracts

Ohio Power objects that the prices used by staff are derived from contracts that were executed at different times than the date of its contract with its affiliate mine. Furthermore, the contracts are for different lengths of time than the term of the contract with its affiliate. In Opinion No. 133, the Commission recognized that the long-term reliability of a contract with an affiliate, and the market conditions at the time a long-term contract is negotiated, are circumstances that might justify differences in the prices of coal that otherwise has comparable characteristics.[43] In a competitive market, prices

[42] Staff calculated a comparable market price based on the coal from the eight plants which used the 1-2% sulfur coal. As can be seen, the coal at these plants was also less costly than Martinka coal:

[Continued]

fluctuate in response to supply and demand, and to changes in the purchasing power of the dollar. Therefore, spot prices today may not be comparable to the prices derived from a 35-year contract executed 10 years ago.[44] Long-term contracts executed in a soft market, i.e., when supply is greater than demand and prices are depressed, would likely yield lower prices than contracts entered during a period of tight supply and high demand, even though the coal involved is identical in price-affecting characteristics.

Ohio Power argues that the contracts in staff's study were inappropriate in terms of contract vintage. Ohio Power asserts that, to establish a market price, the Commission should look only at contracts entered into at the same time as its Martinka contract.[45] Seventy-five percent of the contracts in staff's study were entered into after the Martinka contract.[46] The 1970s were a period of almost continuous inflation. Contracts made later in the decade, after the Martinka contract, would likely reflect higher prices. Staff therefore argues that its use of later-vintaged contracts tended to produce average prices above the level that would be truly comparable to the Martinka contract.[47]

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[42] [Continued]

	*Comparable Coal (1-2% sulfur)**	*Martinka Coal*	*Percentage Difference*
1980	141.0¢/MMBtu	184.9¢/MMBtu	31%
1981	152.9	268.7	76%
1982	176.0	206.8	18%

* Adjusted up by 3.1% from Form 423 data.

[43] 17 FERC at p. 61,246.

[44] Ohio Power's contract for Martinka coal was executed in 1972 for a term of 35 years.

[45] Ohio Power brief opposing exception at 53-54.

[46] 25 FERC at p. 65,197; Ex. 15 at 15, Ex. 15RR at 5.

[47] Staff brief on exceptions at 60 n.30.

Ohio Power's witness, Mr. Renton, testified that the coal market was "soft" from late 1971 until early 1973.[48] Supply exceeded demand and prices were low. Ohio Power's contract for Martinka coal was dated October 1, 1972, in the midst of the soft market. The Arab oil embargo and sharp increases in the world price of crude oil in 1973 apparently caused a "tight" coal market, and prices moved higher.[49] Mr. Renton characterized the market as soft from late 1974 through early 1979, followed by a tight market for a brief period in 1979 through the first part of 1980.[50] This testimony does not indicate any circumstances in the coal market when the Martinka coal contract was made that would justify unusually high prices. Nor does it indicate that prices derived from later-vintaged contracts are likely to be lower than prices reflecting the 1972 market conditions.

Staff utilized a statistical analysis technique to attempt to discern a correlation between the prices paid under its set of comparable contracts and the vintages of those contracts. Its analysis failed to show any consistent, discernible correlation.[51] The judge ultimately concluded that vintages could affect the prices, and should be looked at carefully.[52] We agree. The parties have adequately considered the possible effects of vintage on the prices derived from staff's set of comparable contracts. The only conclusion we can draw is that staff's benchmark prices may be higher, i.e., skewed in favor of Ohio Power, than if only contracts of the Martinka vintage were used for comparison.

Ohio Power presented evidence of correlations between higher prices and larger quantities of coal delivered un-

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[48] Tr. 639-41.

[49] Tr. 641.

[50] Tr. 642-43.

[51] 25 FERC at p. 65,187, Ex. 13G at 15.

[52] 25 FERC at p. 65,199.

der a contract, and between higher prices and contracts of longer duration.[53] The reliability of the data used to show these correlations and the validity of the conclusions drawn were contested by staff. The judge declined to draw any conclusions from the welter of conflicting testimony on these contentions.[54] Staff points out that Ohio Power failed to quantify what adjustments to staff's benchmark prices would be warranted if Ohio Power's alleged correlations were accepted.[55] We are likewise unable to conclude on the basis of the record evidence that the asserted correlations exist, or if so, what adjustments to the benchmark prices they would warrant.

(c) Other Measures of Comparability

(i) Mine-mouth plants

Ohio Power argued that mine-mouth plants should be excluded from the set of contracts used by staff in developing the benchmark prices because the delivered prices of coal to such plants would not include any significant transportation costs, while the delivered prices to the Mitchell plant include such costs.[56] In order to test Ohio Power's claim, staff excluded mine-mouth plants burning 1-4% sulfur coal within 50 miles of Mitchell and found that the average price was slightly lower in 1980 (-2.7¢ MMBtu or 2.3% lower), and slightly higher in 1981 (+0.1¢ or 0.1% higher) and 1982 (+3.0¢ or 2.0% higher). Staff's analysis shows that the delivered prices of coal to mine-mouth plants are not significantly different from delivered prices to the other plants in the region.[57] Therefore, we find staff's inclusion of mine-mouth plants in its set of comparable contracts acceptable.

[53] 25 FERC at p. 65,199, Ex. 9H at 9-15.

[54] 25 FERC at p. 65,199.

[55] *See, e.g.*, Staff brief on exceptions at 61-62, n.30, 73-74.

[56] Ex. 9F, *see also* Ohio Power brief opposing exceptions at 49.

[57] *See, e.g.*, Ex. 136 at 17-18, Ex. 15QQ at 3.

(ii) Transportation costs

Ohio Power questioned staff's reliance on delivered prices to plants other than Mitchell without considering the possible effects of differing costs of transportation. Ohio argued that the delivered price of some alternative coal supply might be higher (or lower), if delivered to the Mitchell plant rather than some other plant in the region, if the transportation costs are different.[58] However, the marginal differences in the costs of transporting coal to any point within a 50-mile radius are likely to be small, and there is no reason to anticipate that the average of any such differing costs to other plants would be lower than the transportation costs of shipping coal to the Mitchell plant.[59]

(iii) Geographical area

Ohio Power argues that if staff's 100-mile radius were slightly extended it would then include three more plants whose coal prices would significantly increase the averages and that "a natural break in the chain of substitution" occurs just beyond the extended radius.[60] Staff points out that two of the plants Ohio Power wants to include in the sample burn coal with less than 1.0% sulfur and would thus be outside the range of comparable coal. The coal prices at the other plant are only slightly higher than the average of those within the 100-mile radius.[61]

Drawing a line at 50 miles or 100 miles obviously involves an element of discretion. If a 100-mile radius is reasonable, it is unlikely that a 105-mile radius would be unreasonable. But once the line has been drawn, and

[58] Ohio Power brief opposing exceptions at 50.

[59] Differing transportation costs would have to be considered if benchmark prices were derived from only one or two comparable contracts.

[60] Ohio Power brief opposing exceptions at 48.

[61] Ex. 15QQ at 1-3.

there are reasonable arguments to support where it is drawn, the burden is on a challenger to demonstrate convincingly that the line should be drawn elsewhere. Ohio Power's proposal to include one more plant using coal with comparable sulfur content does not carry that burden.

We find that the presence of 13 plants within 50 miles that burn coal with price-affecting characteristics suitable for use at Mitchell provides an adequate sample of the relevant market by which to compare Martinka prices.

(iv) Price premium for affiliate supply

Ohio Power claimed that, in comparing affiliate coal prices with market prices, affiliate coal prices should be adjusted to reflect a price premium warranted by the security and reliability of an affiliate coal supply.[62] Ohio Power, however, makes no attempt at quantifying this price premium. In fact, the evidence indicates that, at least during the 1981 coal strike, the supply of Martinka coal was not as reliable as Ohio Power alleges it to be. We have considered the reliability premium argument raised by Ohio Power, but find that the company failed to meet its burden of demonstrating that such a premium is warranted.

(v) Mine type

Finally, Ohio Power argues that staff's inclusion of stripmine coal in its sample tends to produce a lower average price than if only coal from underground mines were considered. Ohio Power asserts that coal from underground mines is generally more expensive than otherwise comparable coal from strip mines.[63] However, staff's evidence shows that the strip-mine coal in its sample was more costly than the coal from underground mines.[64]

[62] Ohio Power brief opposing exceptions at 60-62.

[63] Ohio Power brief opposing exceptions at 61.

Even if Ohio Power's assertion is generally true, there is nothing in the record to justify paying a premium for coal from an underground mine if suitable coal is available at less cost from a strip mine.

(d) Average Price versus Range of Prices

Ohio Power argues that when a set of contracts are identified as comparable, the prices under these contracts should be viewed as establishing a range of reasonable prices. If prices under the affiliate contract fall within the range, they should be deemed reasonable. If they are above the highest prices in the range, refunds should be required to bring the affiliate contract prices down to the highest prices in the range, but no lower.[65] The effect of Ohio Power's approach would be to make the contract with the highest prices the benchmark, and to disregard prices under the other contracts. However, we cannot ignore the other contracts in the group unless the similarities between the affiliate contract and the contract with the highest prices are so striking, and the dissimilarities of the other contracts in the group so significant that the highest-priced contract should clearly serve as the benchmark. Ohio Power did not argue that its Martinka contract was strikingly similar to the highest priced comparable contract.

Moreover, the use of a weighted average price is a convention frequently employed to establish a reasonable midpoint.[66] It is more appropriate than relying on the highest-priced coal under any reasonably comparable contract to set the market standard and effectively ignoring all other lower prices under other reasonably comparable contracts.

[64] Ex. 15QQ at 3-5, Ex. 15RR at 6-7.

[65] Ohio Power brief opposing exceptions at 4, 13-17.

[66] *See Tennessee Gas Pipeline Co.*, 38 FERC ¶ 61,306 (1987).

(e) Ohio Power's Market Price Evidence

Ohio Power submitted evidence of its bid solicitations in 1980 and 1981 for Martinka-quality coal and the responses from independent coal suppliers.[67] Current bids are not likely to reflect the same factors affecting prices under the contract for Martinka coal, signed 10 years earlier, and original bids are likely to be higher than finally negotiated contracts. Nevertheless, we agree with the judge that evidence of current bids is relevant to discerning current market prices.

Staff notes that the average delivered price of the six lowest bidders in 1980 was roughly $1.42 MMBtu.[68] This compares to the $1.41 adjusted benchmark price that staff derived from its set of comparable transactions (for 1-2% sulfur content coal) while Ohio Power paid $1.85 MMBtu for Martinka Coal.[69] The 1981 solicitation identified seven suppliers who bid to supply low sulfur coal (comparable to Martinka), with ash-fusion temperatures and other characteristics that met Ohio Power's bid specifications, at an average delivered price of roughly $1.54 per MMBtu.[70] This compares to staff's conclusion that the comparable market price for low sulfur coal (1-2%) that year was $1.53, while Ohio Power paid $2.69 for Martinka coal.[71] Thus, Ohio Power's bid

[67] Ex. 15DD.

[68] Staff brief on exceptions at 42.

[69] *See* n.42, *supra*.

[70] Staff brief on exceptions at 43, Ex. 15LL at Sch. 6.

[71] *See* n.42, *supra*. The judge noted that the Martinka mine was closed during part of 1981 because of a strike and other operating difficulties. 25 FERC at p. 65,182. Because Ohio Power's contract obligates it to pay the Martinka mine's fixed costs regardless of the amount of production, Tr. 734, the unit cost of Matrinka coal was abnormally high in 1981. Therefore, the bid prices averaging $1.54 might be more properly compared to the $2.07 paid for Martinka coal in 1982.

evidence can be viewed as supporting staff's position on comparable market prices.

The judge said that the 1980 and 1981 bid solicitations lead to the conclusion that Martinka-quality coal could have been obtained at a cheaper price than was paid by Ohio Power.[72] However, he found this conclusion to be tempered by the fact that the market may have been soft in those years.[73] The average price of 22 offers made in 1980 ($1.58/MMBtu) compares to staff's adjusted weighted average price of $1.41/MMBtu for low-sulfur coal used within a 50-mile radius. In 1981, Ohio Power's average of 20 offers ($1.76/MMBtu) compares to staff's comparable benchmark price of $1.53/MMBtu. However, the judge's ultimate conclusion that Martinka prices "are not too bad" was based on his comparisons of the $40 per ton (converted from cents per MMBtu) average of the 1980 bids to the $44.10 per ton paid for Martinka coal and the $45 per ton average of the 1981 bids to the $48 per ton paid for Martinka coal in 1982 (substituting 1982 Martinka prices for 1981 prices to avoid the distortions caused by the strike).[74]

We think the prices from the lower bids are more indicative of market prices. Bids are indicative of market prices to the extent they are likely to be accepted and form the prices for transactions. Actual transactions are more likely to develop from among the range of lowest bids. Consequently, we believe staff's average of the lower bids is more indicative of current market prices than the average of all bids used by the judge as the basis for his conclusions.

Ohio Power also identified four coal seams owned by independent coal suppliers, within a 75-mile radius of the

[72] 25 FERC at p. 61,195.

[73] *Id.*

[74] *Id.*

Mitchell plant, that could provide Martinka-quality coal.[75] Ohio Power compared the weighted average prices of coal from this sample of mines to show that Martinka coal was $6.89 per ton more expensive in 1980, and $17.82 more expensive in 1981 (the abnormal year), but $6.08 per ton less expensive in 1982.[76]

Ohio Power's study was offered to show the reasonableness of the cost of Martinka coal but not to serve as the basis for repricing the coal.[77] However, even if it had been offered for the purpose of establishing a comparative market price, we would not find it adequate. There is substantial evidence that the relevant geographic market based on the location of mines rather than proximate coal-fired plants would approximate the geographic boundary of the Department of the Interior Bureau of Mines Districts Nos. 1-8, a much larger area than a 75-mile radius. The coal burned in other plants near Mitchell comes from those districts.[78] Ohio Power's bid solicitations went to companies with mines in those districts.[79] Ohio Power argues that coal from beyond 75 miles is usually not competitively priced because of the transportation costs. However, several suppliers from well beyond 75 miles (and within District Nos. 1-8) were among the bidders with the lowest delivered prices.[80] Ohio Power's study focused on prices of relatively small quantities of coal, and there are several other aspects of the study, as the judge noted,[81] that preclude us from according it weight as an indicator of comparable market prices.

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[75] Exhibit 4 at 33-39.

[76] Exhibit 4K.

[77] Ex. 4 at 37.

[78] Ex. 15 at 15, Ex. 15BB, Ex. 15CC.

[79] Ex. 13 at 15.

[80] Ex. 15LL at Sch. 6.

[81] 25 FERC at p. 65,203.

2. Burden of Proof

Under section 205(e) of the Federal Power Act and § 35.13(e)(3) of the Commission's regulations,[82] the utility bears the ultimate burden of proving that its rates are just and reasonable. Application of the burden of proof is described in *Minnesota Power & Light Co.*

> [U]tilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent . . . . However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.[83]

The judge in this proceeding found that staff's evidence created a serious doubt as to whether the price paid for Martinka coal was prudent. He stated that Ohio Power "convincingly erased that doubt but did this primarily by attacking the staff's presentation rather than by an affirmative showing of prudence."[84] The judge then found that Ohio Power had satisfied "whatever legal requirement is involved in meeting its burden."[85] We disagree. Ohio Power did not dispel the doubts raised by the staff's evidence and did not prove affirmatively that its fuel costs were reasonable.

Staff has shown that Ohio Power paid in excess of the market price for the Martinka coal, and Ohio Power did not rebut this showing. Moreover, Ohio Power failed to come forward with evidence that its affiliate coal costs were reasonable in comparison to market prices. As de-

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[82] 16 U.S.C. § 824d(e) (1982); 18 C.F.R. § 35.13(e)(3) (1986).

[83] 11 FERC ¶ 61,312, at p. 61,645 (1980). *See also, Anaheim v. F.E.R.C.*, 669 F.2d 799, 809 (D.C. Cir., 1981).

[84] 25 FERC at p. 65,202.

[85] *Id.*

scribed above, all Ohio Power sought to do was cast doubt on different elements of staff's case. Ohio Power never attempted to show what the market price of coal was and therefore failed to show affirmatively that the prices it paid for the Martinka coal were reasonable. Ohio Power also failed to show that staff's evidence did not establish a market price with which to compare the cost of Martinka coal. We therefore shall reverse the judge's conclusion that Ohio Power met its burden of establishing that its costs were reasonable.

3. Conclusion

Our review of the record leads us to conclude that staff's market study, identifying plants within 50 miles of Mitchell that burn coal of comparable Btu content to that of Martinka coal and with suitable sulfur content (within a one to four percent range), provides a reliable calculation of comparable market prices by which to judge the reasonableness of Ohio Power's Martinka coal costs. The comparison [86] demonstrates that Ohio Power's costs of Martinka coal were 50% above market in 1980, 94% in 1981, and 33% in 1982. We have already considered proposed adjustments to the prices of comparable transactions to account for differences between the Martinka coal and that of comparable or suitable coal. We have considered differences in vintage, quantity, and duration of the contracts, and all other factors that the parties have suggested may justify higher prices for Martinka coal. Ohio Power has not justified disparities of the magnitude noted above.[87]

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[86] *See* chart in section II.B.1. of this Opinion.

[87] We note that Ohio Power's Martinka coal costs have continued to exceed significantly the market price derived from the plants included in staff's study. According to data from FERC Form 423, Martinka's prices have exceeded market by 24.2% to 33.4% in the years 1983 through September 1986. The comparisons are charted below:

Ohio Power suggests that there are many reasons for it to enter into affiliate coal contracts. Among these reasons are the effect of having affiliate coal mines on Ohio Power's ability to negotiate favorable coal contracts with independent coal suppliers. Ohio Power argues that the effectiveness of its coal purchases program is shown by the fact that its electric rates are low in comparison to neighboring utilities' rates. The relative level of Ohio Power's rates, however, is not evidence that its affiliate coal purchases are reasonable. There are a variety of reasons, totally unrelated to coal costs, that a neighboring utility might have differing rates. We therefore are left with a comparison of the Martinka coal prices with market price.

In view of the significance of the deviation between Ohio Power costs for Martinka coal and comparable market prices, we cannot conclude that Ohio Power's purchases of Martinka coal for its Mitchell plant are reasonable costs for its ratepayers to bear. Ohio Power has not submitted evidence which indicates otherwise. We therefore find that Ohio's rates based on those costs are not just and reasonable.

C. Establishing a Just and Reasonable Fuel Charge

Having determined that Ohio Power's rates are not just and reasonable, the Commission must establish a

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	*Comparable Coal (1-4% sulfur)**	*Martinka Coal*	*Percentage Difference*
1983	157.0¢ /MMBtu	195.1¢ MMBtu	24.3%
1984	153.4	199.5	30.1
1985	153.9	191.1	24.2
1986 **	149.1	198.9	33.4

* Adjusted by 3.1% for comparison purposes with staff's 1980-82 figures. We have no evidence that the underreporting noted in EIA's one-month audit, and on which staff relied in its calculations, continues to occur.

** Through September.

fuel charge that will result in a just and reasonable rate. This proceeding is distinguishable in this respect from the proceeding in Opinion No. 133. In that case, the Commission affirmed the judge's finding that the price of affiliate coal was reasonable under the market-price test, and it was, therefore, unnecessary for the Commission to establish an allowable price.

In this instance, the Commission believes it is reasonable to use a market price as the benchmark for Ohio Power's future fuel charges for Martinka coal and from which to calculate refunds for overcollections. For the same reasons that a market-price test is approved for determining the reasonableness of the company's proposed charges, it is appropriate to use the market-price to calculate the just and reasonable rate when the company's charges are found unreasonable, particularly in this case where the parameters for determining a comparable market price have been adequately developed in the market price analysis presented by staff.

Ohio Power posed arguments on and opposing exceptions to the initial decision regarding the adverse effects that would result if this Commission reprices its coal at a market price. For instance, Ohio Power argues that if this Commission reprices its fuel according to market price, while the SEC applies a cost-of-service requirement, it will be "whipsawed" by the two commissions.[88] Ohio Power argues that its investment in the Martinka coal mine should not be judged by focusing on a short-term comparison with prices from alternative non-affiliated suppliers. Even if its prices during the early years of the mine's production may be above the market, that relation may not continue. Ohio Power argues that the payments for Martinka coal, based on costs, may be eventually less than the comparable market prices.[89]

[88] *See, e.g.*, Ohio Power brief on exceptions at 35,62.

[89] The costs which Ohio Power seeks to recover are the equivalent of rate-based regulated costs. Prices under rate-base regulation

Ohio Power states that what may look like a "bad deal" in the short run may prove to be a "good deal" in the long run. However, Ohio Power argues if its charges to its wholesale ratepayers are limited to the market price during the early years of the contract, it will lose money on the transactions if, in the later years when market prices may exceed the cost of producing the captive coal, the SEC limits the affiliate transfer price to costs. Therefore, Ohio Power suggests that it would have no opportunity to recoup the losses it may have incurred in the early years.[90]

Ohio Power argues that the practical effect of having this Commission regulate the transaction with Ohio Power's ratepayers by one standard, while the SEC regulates the transaction with its affiliate by another standard is to limit it to recovery under the lower of the two standards.[91] Ohio argues that this amounts to a partial confiscation of its investment in Martinka, and is unfair and perhaps unconstitutional.[92] It is also detrimental to public policy, Ohio Power argues, because utilities faced with the SEC FERC "whipsaw" will forego the advantages of captive coal mines.[93]

Ohio Power's argument is misplaced. As noted above, we agree with the presiding judge's conclusion that this Commission regulates rates while the SEC regulates the intra-corporate price of coal and that section 318 of the

may be high during the early yc .rs of the inclusion of new plant in rate base. As depreciation expense is recovered, the rate base dwindles and the return on the diminished rate base likewise dwindles (if the rate of return is constant). This phenomenon is called the "front-end load effect" of rate-base pricing.

[90] Ohio Power brief on exceptions at 25, 63, 65.

[91] *See, e.g.*, Ohio Power brief on exceptions at 17, 52.

[92] Ohio Power brief on exceptions at 25, 33, 56. Ohio Power brief opposing exceptions at 70.

[93] Ohio Power brief on exceptions at 63.

Federal Power Act does not preclude the Commission from determining the just and reasonable charge for Ohio Power to recover from its wholesale customers for its purchases from the Martinka mine.[94]

The amount that the SEC allows as the transfer price of coal between Ohio Power and the Southern Ohio Coal Company does not dictate the amount that Ohio Power may recover in rates to its customers for fuel costs. This Opinion orders the company to charge ratepayers, at most, the comparable market price for Martinka coal. Although the SEC may limit the affiliate transfer price to costs even when market prices are higher than costs,[95] for electric rate purposes Ohio Power will have the option to charge its wholesale customers up to the market price for that affiliate coal. Consequently, Ohio Power is not, as it alleges, required to limit its rate recovery of Martinka coal costs to the lower of the two standards.

Allowing Ohio Power to collect the market price, even when the market price exceeds costs, is consistent with our holding in Opinion No. 133 where we stated that "the interests of the consumers will best be protected by permitting utilities that purchase coal from affiliates to recover no more from their ratepayers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier."[96] When market prices are lower than costs, tying fuel charges to the comparable market price assures that ratepayers will pay for affiliate coal no more than they would have paid for non-affiliate coal. On the other hand, when the market price exceeds costs, ratepayers will still be paying no more than what they would pay for non-affiliate coal, and will not be harmed by the affiliate relationship.

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[94] 25 FERC at p. 65,183.

[95] *But see* n.17, *supra*.

[96] 17 FERC at p. 61,246.

Establishing the comparable market price as the allowable fuel charge for affiliate coal supplies in this case will provide an incentive to Ohio Power to ensure that its subsidiary coal company is as innovative and operates as efficiently as possible.[97] The lower the affiliated company's costs, the higher Ohio Power's potential return on investment.

By allowing the collection of the comparable market price, regardless of whether the price is higher or lower than costs, Ohio Power will not be limited to collecting market price only when costs may be higher, which would preclude it from recouping high start-up costs as the costs of mining drop relative to market price. Establishing the reasonable cost of the affiliate coal supply by a comparison with the competitive market allows Ohio Power the same chance to earn a return on investment in its affiliate coal mine as an independent supplier of coal. It is Commission policy that a regulated company should not receive less revenue for its sales due solely to the mere affiliation between supplier and purchaser.[98] Whether or not Ohio Power's commitment to Martinka coal proves to be "a good deal" over the long run will depend on Ohio Power's ability to recover its investment in the mine, plus a reasonable return, without charging its ratepayers for fuel costs in excess of comparable market prices. However, this consideration is irrelevant when a comparable market price is established as a just and reasonable rate. Under the rationale of tying affiliate coal costs to the comparable market price, not only must cost recovery be limited to the market price when actual costs exceed market price, but fuel charges must be allowed up to the market price, even if actual costs are less. Therefore, if, as Ohio Power argues in this case, its investment in the Martinka coal mine will prove to be a

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[97] *Id.*

[98] *Columbia Gulf Transmission Company*, Opinion No. 47, 8 FERC 61,002 (1979), *reh'g denied*, 9 FERC 61,355 (1979).

good deal in the long run, it will benefit by recouping losses that result from the refunds of excessive fuel costs required by this Opinion and order.

D. Calculation of Coal Cost Recovery and Refund

The benchmark price mechanism approved and ordered in this Opinion will establish, for Ohio Power's Martinka coal, the market price, which will be the just and reasonable fuel adjustment charge under the Federal Power Act. The Commission will charge the benchmark price mechanism only prospectively if it can be shown that it no longer serves as a valid tool for determining comparable market prices. As ordered below, Ohio Power must calculate refunds and future fuel adjustment clause collections based on the benchmark price mechanism approved in this Opinion. The benchmark price will be based on data from FERC Form 423 and will be derived from the weighted average delivered price of contract coal to plants within 50 miles of the Mitchell plant and having a sulfur content of 1-4% and a Btu content of not less than 11,500 Btus per pound.[99]

Refunds for excessive coal costs collected through the fuel adjustment clause prior to the filed rates in this proceeding are not mandatory. Staff recommends refunds only from the dates that Ohio Power's proposed rates in this proceeding became effective subject to refund—July 29, 1982 for the Wheeling Electric Company, and December 28, 1982 for the municipals.[100]

The municipals, on the other hand, seek refunds for all of 1980, 1981 and 1982, in addition to excessive fuel costs collected since December 28, 1982. The municipals point out that we have authority to require refunds of

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[99] The Mitchell plant's boilers require coal of not less than 11,500 Btus per pound. Ex. 15 at 13, Ex. 3 at 36.

[100] The suspension order in these proceedings established these dates 20 FERC ¶ 61,081 (1982).

any costs previously collected under a fuel adjustment clause, if such costs are found to be imprudent, unjust or unreasonable, regardless of whether such costs were recovered through rates collected subject to refund.[101]

We must determine whether, and if so to what extent, refunds of historical coal costs are waranted in light of the interests of the customer and the utility.[102] For the reasons stated below, we will require refunds for Ohio Power's collections of its Martinka coal costs only after the effective date of the rate increases under these proceedings.

The Commission did not adopt the comparable market-price test for the reasonableness of affiliated coal costs until the issuance of *Public Service Company of New Mexico*, Opinion No. 133, on November 9, 1981. Prior to that date Ohio Power would not necessarily have anticipated that fuel charges within the cost-based limits imposed by the SEC might not be acceptable under this Commission's regulation. No one challenged the reasonableness of these affiliate coal costs until the instant proceeding. As such, no refunds will be ordered for excessive costs collected prior to the effective date of superseding rates in this proceeding.

The Commission orders:

(A) The initial decision is affirmed and adopted to the extent it is not inconsistent with this Opinion and order. Exceptions to the initial decision not granted in this Opinion are denied.

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[101] *Public Service Company of New Hampshire*, Opinion No. 37, 6 FERC ¶ 61,299 (1979); *Electric Cooperatives of Kansas*, 14 FERC ¶ 61,176 (1981); *Carolina Power & Light Company*, 17 FERC ¶ 61,118 (1981); and *Delmarva Power and Light Company*, 24 FERC ¶ 61,199, at p. 61,461 (1983).

[102] *Second Taxing District of the City of Norwalk v. F.E.R.C.*, 683 F.2d 477, 490 (D.C. Cir. 1982).

(B) Ohio Power shall file revised rates in accordance with this Opinion and order, and refund the difference between amounts collected subject to refund and amounts payable under the revised rates. Refunds shall be made with interest, in accordance with 18 C.F.R. § 35.19(a) (1986).

(C) Ohio Power shall file, within 30 days of the date of issuance of this Opinion and order, an amendment to its fuel adjustment clause. This amendment shall specify the method, consistent with paragraph (D), for estimating monthly fuel charges for billing purposes (unless a lagged fuel adjustment is used) and any true-up procedures to adjust for actual data as it becomes available.

(D) Ohio Power shall calculate the comparable market prices for its purchases of Martinka coal for delivery to its Mitchell plant in accordance with the following method and on the basis of data filed with the Commission on FERC Form 423, and may include up to the comparable market price of Martinka coal in calculating that portion of its monthly fuel charge related to fuel costs associated with generation from the Mitchell plant. The comparable market price shall be the weighted average delivered price of contract coal, having a sulfur content of 1-4% and a Btu content of not less than 11,500 Btus per pound, to plants within 50 miles of the Mitchell plant. To the extent Ohio Power calculates the comparable market price on the basis of estimates, for fuel clause purposes it shall adjust its fuel charges on the basis of the data filed with the Commission on FERC Form 423 within six months of calculating any comparable market price on the basis of estimates. Ohio Power must also revise its demand rates to reflect benchmark prices for Martinka coal used at its Mitchell plant in its Period II working capital estimates.

(E) Ohio Power shall make refunds in accordance with paragraph (B) and implement the procedures required by paragraphs (C) and (D) within 75 days of the

date of issuance of this Opinion and order. However, if an application for rehearing is pending at the end of the 75-day period, the refunds shall be made, and the procedures implemented, within 30 days of the date such application is disposed of by the Commission.

(F) The May 15, 1986 motion of New England Power Company to file an *amicus curiae* brief in this proceeding is denied.

(G) Subdocket 000 of Docket Nos. ER82-553 and ER82-554 are hereby terminated. New subdockets will be assigned to Ohio Power's compliance filings required by this order.

APPENDIX D

FEDERAL ENERGY REGULATORY COMMISSION

Commission Opinions, Orders and Notices

Docket Nos. ER82-553-002, ER82-553-003, ER82-554-002, and ER82-554-003

OHIO POWER COMPANY

Opinion No. 272-A; Opinion and Order Denying Requests for Rehearing, and Denying Request for Stay

(Issued April 7, 1988)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

[Note: Opinion No. 272 on recovery of the cost of coal purchased from an affiliate issued April 30, 1987, appears at 39 FERC P61,098.]

[Opinion No. 272-A Text]

On April 30, 1987, the Commission issued Opinion No. 272 in this proceeding.[1] The Commission affirmed the presiding administrative law judge's conclusion in the

[1] *Ohio Power Company*, Opinion No. 272, 39 FERC P61,098 (1987).

initial decision[2] that the Commission is not precluded by either statute[3] or regulation[4] from determining whether it is just and reasonable for Ohio Power Company (Ohio Power) to recover the full costs of its purchase from the Martinka mine from its wholesale rate payers, and that Ohio Power's affiliate coal costs are subject to the comparable market price test, adopted in Public Service Company of New Mexico, Opinion No. 133,[5] to determine the reasonableness of those costs. The Commission, however, reversed the initial decision by concluding that the costs Ohio Power had recovered for its purchases of Martinka coal were unreasonable when compared with the market price for comparable coal. The Commission ordered Ohio Power to refund amounts collected, as of the effective dates of the rates in these proceedings, to the extent that they reflect a price exceeding the market price for comparable coal.

Ohio Power has filed a request for rehearing. The utility argues that section 318 of the Federal Power Act and section 35.14(a)(7) of our regulations preclude the Commission from considering the reasonableness of Ohio Power's affiliate coal costs. Ohio Power also urges that the Commission's decision was not based on substantial evidence. Ohio Power believes the Commission should have analyzed its coal purchases using a prudence standard which, it contends, would have resulted in the Commission's approving the utility's affiliate coal costs. Ohio Power further contends: that the comparable market price test in this case is inconsistent with the standard

[2] *Ohio Power Company*, 25 FERC P63,060 (1983).

[3] Section 318 of the Federal Power Act, 16 U.S.C. § 825q (1982).

[4] 18 C.F.R. § 35.14(a)(7) (1987).

[5] 17 FERC P61,123 (1981), *reh'g denied*, 18 FERC P61,036 (1982), *aff'd, Public Service Company of New Mexico v. FERC*, 832 F.2d 1201 (10th Cir. 1987).

used in Tennessee Gas Pipeline Co;[6] that the Commission should look at Ohio Power's total coal procurement and utilization program; and that the record shows that Ohio Power's rates are relatively low. Therefore, the Commission should allegedly not be concerned with the reasonableness of Ohio Power's coal costs because it is the rate and not isolated expense components that must meet the "just and reasonable" test. Ohio Power urges that the Commission should have not ordered refunds because the Commission adopted a novel interpretation of its fuel adjustment clause regulation, extending the market price test of Opinion No. 133 to a utility with above market price coal costs, and because the Commission waited more than three years to reverse the judge's decision that Martinka coal costs were not unreasonable. Ohio Power requests that if the Commission denies rehearing, our refund order should be stayed pending judicial review. Finally, Ohio Power argues that our order has the effect of revising the company's demand rates. The company alleges this is impermissible since those rates were settled earlier in this proceeding.

On June 1, 1987, the Municipal Wholesale Electric Customers of Ohio Power (Municipals) filed a request for rehearing of Opinion No. 272. The Municipals claim that the Commission should have ordered refunds for the period 1980-1982 as well as from the effective date of the rates, December 28, 1982. In addition, they request that the Commission clarify whether refunds are to be based on a market price determined with a 3.1% upward adjustment.[7]

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[6] Opinion No. 269, 38 FERC P61,306 (1987).

[7] As indicated in Opinion No. 272, the 3.1% adjustment was made to compensate for a potential error in the historical data, for purposes of determining whether Martinka coal costs have been execessive. This adjustment was made out of an abundance of caution in assessing the reasonableness of Ohio Power's coal costs. However, in ordering refunds, we directed the utility to calculate refunds using actual data from FERC Form 423 without making any adjustment. 39 FERC at p. 61,289. No further clarification is necessary.

Discussion

The requests for rehearing raise no arguments which warrant changing our decision in these proceedings. We shall, however, address several points raised in the pleadings.

Ohio Power contends that we must conduct a "prudence" analysis in order to assess the reasonableness of its Martinka coal costs. The Commission has already determined in Opinion No. 133 that, as a matter of policy, affiliate coal purchases should be judged by a market price standard, 17 FERC at p. 61,246, and our decision has been affirmed on appeal. 832 F.2d at 1212-14. The utility's argument that we must conduct a "prudence" analysis in the circumstances of this case is without merit.

Ohio Power also argues that our market price test is inconsistent with that used by the Commission in *Tennessee Gas*. In *Tennessee Gas*, we held that in determining the reasonableness of natural gas prices paid to affiliate producers by pipelines, it was appropriate to compare the weighted average price of all affiliate natural gas with prices paid to nonaffiliates by the pipeline and third parties. In this case, we have focused solely on the price paid by Ohio Power for coal from the Martinka mine. The decision in *Tennessee Gas* is inapposite to this case. As Ohio Power admits in its request for rehearing, all pipeline natural gas is fungible, whereas all coal is not. In addition, the question of whether prices paid to affiliated coal suppliers should be averaged, where more than one affiliate relationship is questioned in a particular case, is not present in this proceeding. In any event, Ohio Power has not presented any evidence in support of a determination of market price under the test used in *Tennessee Gas*, and, thus, failed, even under that stand-

ard, to dispel the doubts raised by Staff's evidence as to the reasonableness of the price paid by it for coal from the Martinka mine.

Ohio Power's argument that we erred by revising its demand rates is also misplaced. In approving an earlier settlement in this proceeding, we stated that it would become effective December 28, 1982, not subject to refund as to any issue except to the extent an adjustment is required as a result of the Commission's determination of the captive coal issue. 23 FERC P61,236 (1983). Because the value of Martinka coal as calculated under the market price test affects the amount of fuel stock and working cash included in rate base which, in turn, affects the level of Ohio Power's unit demand charge, our requirement that Ohio Power revise its demand charges is appropriate.

As to Ohio Power's request that we give prospective effect only to our decision, we have already rejected the contention that the application of a market price standard to the facts included in this case represents a change in Commission policy. Ohio Power argues that because it has continued its operation of the Martinka mine pending a final Commission decision, fairness requires that the decision be applied prospectively. The Municipals, on the other hand, request that we apply our decision to coal costs paid prior to the effective date of the rates filed in this proceeding. We carefully considered the interests of both the utility and its customers in Opinion No. 272 in determining that refunds should be ordered as of the date previously chosen, and we find no reason to alter our conclusion in light of the arguments made on rehearing.

Finally, Ohio Power requests that we stay the effect of our order pending judicial review. Section 705 of the Administrative Procedure Act [8] permits an administrative agency to stay its order if it finds that "justice so re-

[8] 5 U.S.C. § 705 (1982).

quires." The inquiry involves a balancing of the various interests involved, including an assessment of whether the party seeking a stay will suffer irreparable harm if the stay is denied. *Town of Highlands, N. C. v. Nantahala Power & Light Co.*, 41 FERC P61,288 (1987); *see also Middle South Energy, Inc.*, 32 FERC P61,207 (1985). In support of its request for stay, Ohio Power focuses on the matter of irreparable harm, alleging that if the Commission's decision is reversed, it will be difficult for the utility to recover the refunded coal costs from its customers.

We shall deny the request for a stay. In the event an appellate court reverses our decision, the Commission would be empowered to order Ohio Power to be made whole. The possibility that the utility might experience difficulty in recouping refunds from its wholesale customers does not constitute irreparable injury. *Nantahala Power & Light Co.*, 21 FERC P61,274 (1982).[9] Further, the utility has not shown that the customers will suffer little, if any, harm by delaying the payments of refunds. We believe that the public interest supports the rapid disbursement of refunds.

The Commission orders:

(A) The requests for rehearing of Opinion No. 272 filed by Ohio Power and the Municipals are hereby denied.

(B) The alternative request by Ohio Power for a stay of the Commission's order issued in Opinion No. 272 is hereby denied.

(C) Subdockets -002 and -003 of Docket Nos. ER82-553 and ER82-554 are hereby terminated.

[9] *See also Virginia Petroleum Jobbers Association* v. *FPC*, 259 F.2d 921, 925 (D.C. Cir. 1958).

No. 89-1283

Supreme Court, U.S.
FILED
MAR 1 1990
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1989

ARCADIA, OHIO, ET AL., PETITIONERS

v.

OHIO POWER COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT

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QUESTION PRESENTED

Whether Section 318 of the Federal Power Act (16 U.S.C. 825q), which governs "Conflicts of jurisdiction" between the Federal Energy Regulatory Commission (FERC) and the Securities and Exchange Commission (SEC), precludes FERC jurisdiction whenever the FERC and the SEC have jurisdiction to regulate the same subject matter, or only when there is an actual conflict between a requirement of the FERC and a requirement of the SEC.

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BRIEF FOR THE FEDERAL RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-28a) is reported at 880 F.2d 1400. The opinion of FERC (Pet. App. 31a-67a) is reported at 39 F.E.R.C. (CCH) ¶ 61,098. The opinion of FERC denying rehearing (Pet. App. 68a-73a) is reported at 43 F.E.R.C. (CCH) ¶ 61,046.

JURISDICTION

The court of appeals entered its judgment on July 28, 1989. Rehearing petitions filed by FERC and petitioners were denied on October 12, 1989. Pet. App.

29a-30a. On January 2, 1990, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including February 9, 1990, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Public Utility Act of 1935, ch. 687, 49 Stat. 803, had "two primary and related purposes: to curb abusive practices of public utility companies by bringing them under effective control, and to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce." *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 758 (1973). The Act was divided into two titles, administered by two separate agencies, to achieve these purposes. This case raises the issue of the circumstances under which the regulatory regime created by one title supersedes the regime created by the other.

Title I of the Act contained the Public Utility Holding Company Act (PUHCA), 15 U.S.C. 79 *et seq.*, which subjected public utility holding companies to regulation by the SEC. One of the principal remedial purposes of PUHCA was to protect investors and consumers by preventing public utility holding companies and their subsidiaries from paying or receiving unjustified prices for goods or services due to "an absence of arm's-length bargaining or from restraint of * * * competition." 15 U.S.C. 79a(b)(2). To this end, Section 13(b) of PUHCA, 15 U.S.C. 79m(b), makes it unlawful for affiliates of a public utility holding company to contract with each other:

> except in accordance with such terms and conditions and subject to such limitations and prohibitions as the [SEC] by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies.

The SEC has adopted rules implementing this standard. SEC Rule 90 prohibits associated companies from making or performing contracts for sale of goods or performance of services "at more than cost." 17 C.F.R. 250.90(a)(2). The sale between affiliates of seller-produced goods is not "limited to cost," 17 C.F.R. 250.90(d), but such a seller still may not charge its affiliate more than a fair market price. 17 C.F.R. 250.92(b). The net effect of these rules is that, in the absence of an SEC order governing a transaction, seller-produced goods must generally be sold at the lower of cost or market.

Title II of the Public Utility Act of 1935 enacted Part 2 of the Federal Power Act (FPA), 16 U.S.C. 824 *et seq.* These provisions authorized the Federal Power Commission (the predecessor to FERC, see 42 U.S.C. 7172(a)(1)(B), 7293) generally to regulate wholesale electric rates charged by public utility operating companies in interstate commerce in order to ensure that such rates are "just and reasonable." 16 U.S.C. 824d.

Section 213 of the Public Utility Act of 1935, now Section 318 of the FPA, 16 U.S.C. 825q, was designed to govern conflicts between the potentially overlapping authority granted to the two agencies. Entitled "Conflict of jurisdiction," this provision essentially provides for SEC precedence in cases of conflict: "If, with respect to the issue, sale, or guaranty of a security, * * * or the acquisition or disposition of any

security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of [the PUHCA] * * * and to a requirement of [the FPA], the requirement of [the PUHCA] shall apply to such person, and such person shall not be subject to the requirement of [the FPA] * * * with respect to the same subject matter." Section 318 permits the SEC to exempt a firm subject to requirements under both the PUHCA and the FPA from the PUHCA provision, thus making the FPA provision applicable. 16 U.S.C. 825q.[1]

2. This case arose out of a rate increase proposal that Ohio Power, a utility operating subsidiary of American Electric Power Company, Inc., filed with FERC in 1982 pursuant to Section 205 of the FPA, 16 U.S.C. 824d. In the proceedings that resulted from the Ohio Power filing, certain parties challenged Ohio Power's pass-through to its ratepayers of the price

[1] The complete text of Section 318 is:

Conflict of jurisdiction. If, with respect to the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 [15 U.S.C. 79 et seq.] or of a rule, regulation, or order thereunder and to a requirement of this chapter or of a rule, regulation, or order thereunder, the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this chapter, or of any rule, regulation, or order thereunder, with respect to the same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this chapter shall apply to such person.

that it had paid to its subsidiary, the Southern Ohio Coal Company (SOCCO), for coal purchased from SOCCO. Pursuant to a contract between Ohio Power and SOCCO, the price was based on SOCCO's costs.

In 1971, Ohio Power, as part of a public utility holding company system, had required authority from the SEC to undertake certain activities. Acting on an application to create SOCCO as a coal-mining subsidiary, the SEC provided in its order that "[t]he charges for coal by [SOCCO] will be based on an amount equal to the actual cost of [SOCCO] in developing the reserve and mining such coal, including all appropriate overheads and interest charges and including a reasonable rate of return on Ohio Power's equity investment in [SOCCO]." *In re Ohio Power Co.*, SEC Holding Co. Act Release No. 17383, at 2 (Dec. 2, 1971); see Pet. App. 21a. In three subsequent orders authorizing further financing for SOCCO's mining operations, the SEC had stated that the price at which SOCCO coal would be sold to Ohio Power would "not exceed the cost" to SOCCO. *In re Ohio Power Co.*, SEC Holding Co. Act Release No. 20515, 14 SEC Dkt. 928, 929 (Apr. 24, 1978); *In re Southern Ohio Coal Co.*, SEC Holding Co. Act Release No. 21008, 17 SEC Dkt. 310, 312 (Apr. 17, 1979); *In re Southern Ohio Coal Co.*, SEC Holding Co. Act Release No. 21537, 19 SEC Dkt. 1309, 1309 (Apr. 25, 1980).

Ohio Power contended that the four SEC orders had approved its contract to purchase the coal "at cost" from SOCCO pursuant to Section 13 of the PUHCA. Therefore, according to Ohio Power, Section 318 barred FERC from allowing rate recovery of a lesser amount than the cost-based price specified in the SEC-approved contract.

Following an investigation initiated by FERC under Sections 205 and 206 of the FPA, FERC concluded that Section 318 did not bar it from prohibiting the pass-through of any excessive payment Ohio Power had made to its affiliate SOCCO for the "captive" coal. As the Commission viewed it, while PUHCA authorizes the SEC to approve contracts for affiliate sales at cost, that statute did not bar FERC, which operates under a statutory mandate to protect ratepayers from excessive charges, from prohibiting the pass-through in rates of any portion of a utility's coal costs that are not just and reasonable in light of market conditions.

The Commission found that this approach was particularly warranted in this case, since the evidence showed that Ohio Power had paid SOCCO about 25-33% over prevailing market prices for coal during the period from 1982-1986. Pet. App. 58a-59a.[2] FERC therefore ordered Ohio Power to refund the difference; pursuant to that directive, Ohio Power has refunded $13.4 million (of which it still disputes $3.4 million) to its wholesale customers.

3. A divided panel of the D.C. Circuit granted Ohio Power's petition for review and reversed FERC's decision. Interpreting Section 318 *de novo*,[3] the panel majority ruled that "[t]he price term of sales con-

[2] The Commission also found that Ohio Power had paid SOCCO "50% above market in 1980 [and] 94% in 1981," the two years before the initiation of the proceedings before FERC. Pet. App. 58a.

[3] The court initially determined that since Congress had designed Section 318 to allocate jurisdiction between FERC and the SEC, Section 318 could not be deemed "entrusted to FERC's administration" and accordingly FERC's interpretation of Section 318 was not entitled to deference. Pet. App. 8a.

tracts between associated companies are [*sic*] subject to SEC jurisdiction under PUHCA * * * and are [*sic*] therefore a 'subject matter' * * * if such price term is also subject to the requirements of the FPA." Pet. App. 9a. Because, in the court's view, the FERC order at issue "set * * * a different price term for such a contract" (*ibid.*), "[t]he conclusion that the same subject matter is implicated is inescapable." Pet. App. 9a-10a.

Having held that the SEC and FERC regulated the "same subject matter," the court went on to hold that this conclusion alone was sufficient to bar FERC's jurisdiction under Section 318. Pet. App. 14a-16a. FERC had argued that, even if the same subject matter were being regulated by both FERC and the SEC, the "requirements" set by both agencies were consistent. The applicable SEC rules and orders were alleged to have referred to cost as only a ceiling price —not an actual price—for the coal contract between Ohio Power and SOCCO. Because the market price of coal relied upon by FERC was lower than the cost of coal as determined under SEC rules, FERC argued that there was no conflict between the FERC rule requiring market-based pricing and the SEC rule allegedly setting cost as a ceiling price. See FERC C.A. Br. at 23-28.

The court held that this argument proceeded from a "false premise." Pet. App. 14a. The court held that Section 318 preempts FERC so long as FERC in effect attempts to regulate the same subject matter as the SEC, even if the FERC order and the SEC regulation pose no actual conflict. As the court stated, "The fact that FERC's market approach produces a current result that does 'not exceed' cost * * * does not make [Ohio Power] any less subject to section 13(b) or to the SEC's orders." Pet. App. 14a.

In an opinion concurring in the judgment, Judge Mikva disagreed with this latter holding. Judge Mikva noted that, because Section 318 speaks in terms of conflicting "requirements" of FERC and the SEC, FERC is divested of jurisdiction under Section 318 only where the "requirements" the SEC and FERC seek to impose are in actual conflict. Pet. App. 19a-22a. He concluded that "because * * * the SEC's orders * * * permit Ohio Power to pay less than cost for coal, FERC's imposition of a market price less than cost does not in this case create a jurisdictional conflict." Pet. App. 23a.[4]

The court of appeals denied petitions for rehearing and suggestions for rehearing *en banc* filed by FERC and petitioners. Pet. App. 29a. Noting that he would have granted the petition for rehearing by the panel, Judge Mikva filed a statement reemphasizing his view that "the statutory interpretation engaged in by the majority * * * generates a no-man's land where neither the [SEC] nor FERC will patrol holding company practices which can oppress consumers, investors and the public." Pet. App. 30a.

REASONS FOR GRANTING THE PETITION

The D.C. Circuit's decision essentially applied a broad "field preemption" analysis to the overlapping FERC/SEC jurisdiction created by the Public Utility

[4] Judge Mikva nonetheless agreed with the majority that the FERC order had to be vacated. In his view, FERC's Rule 35.14(a)(7) (18 C.F.R. 35.14(a)(7)) barred the Commission from imposing a market-price test. Pet. App. 23a-28a. In discussing Rule 35.14(a)(7) in its own decision, FERC had held that it merely "creates a presumption of reasonableness, not a conclusive finding of reasonableness" with respect to pricing at cost. Pet. App. 41a. The majority did not discuss this issue.

Act of 1935. Under the court's analysis, if the SEC has taken any regulatory steps with respect to a given subject matter—or even if the statute grants the SEC authority to take such steps—FERC is apparently precluded from any form of regulation of that subject matter. This interpretation of Section 318 is in substantial tension with settled judicial precedent and the language and legislative history of Section 318. It threatens considerable interference with the proper and efficient allocation of jurisdiction between the FERC and the SEC and creates the potential for a serious regulatory gap with respect to federal (and by implication state) regulation of utility rates. For these reasons, and because the view of FERC, as an agency responsible for administering the Public Utility Act of 1935, is entitled to substantial deference with respect to the question presented in this case, see *Chevron USA Inc.* v. *NRDC*, 467 U.S. 837 (1984), we support the petition for a writ of certiorari. See Sup. Ct. R. 12.4.

1. The D.C. Circuit's decision is in substantial tension with the holding of the Fourth Circuit in *Appalachian Power Co.* v. *FPC*, 328 F.2d 237, cert. denied, 379 U.S. 829 (1964), that Section 318 requires a much more focused "actual conflict" analysis. *Appalachian Power* involved a claim by a power company that, because the FPC and the SEC had both prescribed accounting rules for it, Section 318 excused it from compliance with the FPC requirements. The Fourth Circuit expressly held that "[u]nder section 318 of the Federal Power Act * * * *actual conflicts* between the FPC and the SEC are resolved in favor of the SEC." 328 F.2d at 250 (emphasis added). After a careful analysis of the accounting rules at issue, the court concluded that, although both agencies prescribed accounting rules, the two sets of rules were

not inconsistent. Therefore, the court held that "the effort to discover an *incompatibility* between the two governmental agencies must fail." *Id.* at 252 (emphasis added). The court's ruling that Section 318 did not divest the FPC of jurisdiction unless an "actual conflict" or "incompatibility" between FPC and SEC regulation were shown is inconsistent with the result reached by the D.C. Circuit in this case.

In reaching its conclusion that an actual conflict analysis is appropriate under Section 318, the Fourth Circuit relied on this Court's decision in *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944).[5] In *Northwestern*, a holding-company utility argued that, although there was no present conflict between the SEC's and the FPC's accounting requirements, the authority of the SEC to impose accounting requirements generally preempted the FPC under Section 318 from imposing accounting requirements of its own. The Court rejected the preemption claim on the ground that "no conflict" existed between the FPC's requirements and those of the SEC. 321 U.S. at 125. Although the Court's brief discussion of the issue in *Northwestern* occupies only a single paragraph, the result in *Northwestern* also suggests that the D.C.

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[5] The Fourth Circuit also relied on a letter from the Chairman of the SEC to the Solicitor General that was made a part of the record in *Northwestern*. In a portion of that letter not quoted in the Fourth Circuit's decision, the SEC explained:

> Section 318 of the Public Utility Act of 1935 resolves the question of possible conflicting requirements * * *. Until the S.E.C. does by rule or order impose 'requirements' * * *, there can be no conflict of requirements and Sec. 318 does not apply. It was not intended that utility companies should be able to thwart regulation by the F.P.C. by conjuring up under Sec. 318 imaginary conflicts with *potential* action of the S.E.C.

Resp. Br. App. D at 98-99, *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944).

Circuit erred in rejecting an "actual conflict" approach.

2. The field preemption analysis used by the D.C. Circuit originated in cases involving state regulation of an area that Congress had intended be regulated by the federal government. See, *e.g.*, *Schneidewind* v. *ANR Pipeline Co.*, 108 S. Ct. 1145, 1150-1156 (1988). However, even in the federal/state context, "field pre-emption" is applied only where it can be determined that Congress intended an articulated federal regulatory scheme to "occupy a given field to the exclusion of state law." *Id.* at 1150. In other cases, in which no such congressional intent can be shown, state regulation is found incompatible with a federal regulatory scheme only if there is an actual conflict between a requirement of the state scheme and the federal regulations. See, *e.g.*, *Northwest Central Pipeline Corp.* v. *State Corp. Comm'n*, 109 S. Ct. 1262, 1273-1278 (1989).

The Public Utility Act of 1935 expressly granted regulatory jurisdiction to FERC and the SEC—two *federal* agencies. Although Section 318 certainly demonstrates Congress's intent that SEC regulation should take precedence over FERC regulation, the statute also manifests an intent to permit both agencies to regulate matters that are very closely related. This fact alone suggests that a court should be extremely cautious before concluding, as the court of appeals did, that the mere existence of SEC jurisdiction over a subject matter ousts FERC entirely from the field. Other factors make it clear that a broad field preemption analysis is inappropriate for use in the Section 318 context.

First, the plain language of Section 318 strongly suggests that an actual conflict is necessary. Section 318 itself is entitled "Conflict of jurisdiction," suggesting a recognition that overlapping authority has

been conferred on the two agencies. Moreover, Section 318 gives the SEC precedence only when an entity is subject to "a *requirement* of [the PUHCA] and a *requirement* of [the FPA]" with respect to the same subject matter (emphasis added). Regulatory action permitting a regulated entity to perform any one of a range of permissible actions would not impose a *requirement* at conflict with action by the other agency compelling the regulated entity to take one of the permissible actions. Imposition of inconsistent requirements by both agencies is necessary before Section 318's rule of SEC precedence takes effect.

The legislative history of Section 318 similarly emphasized conflicts in the exercise of jurisdiction, not merely overlapping authority. As the Conference Report explained in regard to Section 318 (H.R. Rep. No. 1903, 74th Cong., 1st Sess. 75 (1935) (emphasis added)):

> In Subsection (a) of Section 318, in which *conflicts* of jurisdiction between the Securities and Exchange Commission and the Federal Power Commission under this bill are resolved in favor of the former, the House amendment adds to such *matters of conflict* the assumption of obligation or liability in respect of a security. The conference substitute is enlarged to include any *conflict arising under* this bill.

Similarly, Section 21 of the PUHCA, 15 U.S.C. 79u (emphasis added), explicitly provides that nothing in the PUHCA "shall affect the jurisdiction of any other commission * * * of the United States * * * insofar as such jurisdiction does not *conflict* with any provision of [the PUHCA] or any rule, regulation, or order thereunder."

Second, use of the broad field preemption analysis to govern the relationship between FERC and the SEC could create a substantial regulatory gap, defeating Congress's intent by leaving transactions effectively unregulated by either agency. It is important to stress that the court of appeals in this case did not simply interpret SEC orders to require Ohio Power to pay cost to SOCCO, and then hold that an actual conflict between the SEC orders and FERC existed.[6] Rather, the court held that, under Section 13(b) of PUHCA, "[i]n the absence of exemption, it is for the SEC rather than FERC to determine the inter-associate price." Pet. App. 14a. Thus, FERC is apparently ousted of power with respect to any "subject matter" that may arise under both the PUHCA and the FPA, notwithstanding the fact that the SEC may have never acted at all with regard to that subject matter. This threatens to create regulatory gaps far beyond the matters at issue in this case or, indeed, the subject matters governed by Section 13(b).[7]

3. Finally, the importance of the question presented is underscored by the potential rate impact on Ohio Power's customers in this case. As noted above, Ohio Power paid its affiliate 25-33% over prevailing market prices for coal during 1982-1986, and over

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[6] Because the court of appeals did not reach the issue of whether in fact the SEC and FERC orders imposed conflicting requirements in this case, that issue would be open on remand.

[7] Indeed, one of the principal goals of the Public Utility Act of 1935 was to eliminate the regulatory gap that existed at that time because, in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83, 86-90 (1927), this Court had held that certain sales of electricity were in interstate commerce and thus beyond the reach of state regulation. See *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 340 (1982). See generally Note, *Federal Regulation of Holding Companies: The Public Utility Act of 1935*, 45 Yale L.J. 468 (1936).

50% above market in 1980 and 94% in 1981. Petitioners reasonably catalogue the potentially far-reaching consequences of a decision that could hinder effective regulation of utilities that directly or indirectly serve 49 million households in 30 states and the District of Columbia. Pet. 17-18.[8]

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MARCH 1990

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[8] Judge Mikva's conclusion, in concurring in the result reached below (see Pet. App. 30a) that FERC's own regulation barred it from applying a market-based test to Ohio Power's coal purchases from SOCCO ought not deter the Court from granting the petition. Since the majority did not address the meaning of the FERC regulation on which Judge Mikva relied, the interpretation of that regulation would remain open on remand. FERC has argued both in its brief to the panel and in its petition for rehearing that the regulation creates no such bar to the action taken in this case. See C.A. Br. 30-32; C.A. Pet. for Rehearing 12-14.

* The Solicitor General is disqualified in this case.

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No. 89-1283

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF ON BEHALF OF RESPONDENTS LCP CHEMICALS, INC., MOBAY CORPORATION, OLIN CORPORATION, AND PPG INDUSTRIES, INC. IN SUPPORT OF THE PETITIONERS

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DESCRIPTION OF INDUSTRIAL RESPONDENTS

This brief is presented on behalf of LCP Chemicals, Inc., Mobay Corporation, Olin Corporation, and PPG Industries, Inc., collectively referred to herein as "Industrial Respondents." Industrial Respondents were intervenors in the cases below before the Federal Energy Regulatory Commission and the Court of Appeals. Industrial Respondents are large West Virginia industrial

retail electric service customers of Wheeling Power Company ("Wheeling"), an entire requirements wholesale customer of Respondent Ohio Power Company ("Ohio Power"). Wheeling and Ohio Power are two of the eight operating public utility subsidiaries of American Electric Power Company ("AEP").

Industrial Respondents collectively purchase 680 million to 820 million kilowatthours per year at retail rates set for Wheeling by the Public Service Commission of West Virginia ("PSCWV"). Industrial Respondents' electricity purchases represent approximately 42 percent of Wheeling's West Virginia retail business. The PSCWV includes in Wheeling's rates a component, adjusted at least semi-annually, to provide for recovery of the cost of wholesale power and energy it purchases from Ohio Power. Thus, the cost of power purchased by Industrial Respondents includes the cost of Wheeling's purchase from Ohio Power, including the cost at issue in this proceeding.[1]

Of the $10.394 million Ohio Power refunded to Wheeling on May 6, 1988 covering the period from July 1982 through January 1988, approximately $4.309 million or 42 percent would be due to the Industrial Respondents, exclusive of additional refunds and interest accruing since that time.

STATEMENT

Industrial Respondents accept the Statement and support and adopt the Questions Presented and Reasons for Granting the Petition contained in the February 9, 1990 Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit filed by Petitioners, Arcadia, Ohio, et al.

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[1] Ohio Power's wholesale rates to Wheeling and to petitioners are not identical but are affected in the same manner by the issues raised in the petition for certiorari.

All applicable statutes, regulations, decisions, and authorities are contained in the Petition for Certiorari.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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BRIEF IN OPPOSITION OF RESPONDENT OHIO POWER COMPANY

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STATEMENT AS TO AFFILIATED COMPANIES

Pursuant to Sup.Ct.R. 28.1, Respondent Ohio Power Company presents the following list of publicly-owned parent, subsidiary and affiliated companies:

American Electric Power Company, Inc.
Appalachian Power Company
Cardinal Operating Company
Columbus Southern Power Company
Indiana Michigan Power Company
Integrated Communications Systems, Inc.
Kentucky Power Company
Ohio Valley Electric Corporation

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BRIEF IN OPPOSITION OF RESPONDENT OHIO POWER COMPANY

STATEMENT OF THE CASE

Ohio Power Company (Ohio Power), as an affiliate of a registered utility holding company, is subject to regulation both by the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. §§ 79a *et seq.*, and by the Federal Energy Regulatory Commission (FERC) under the Federal Power Act (FPA), 16 U.S.C. §§ 824 *et seq.* Recognizing that the existence of dual jurisdiction could lead to conflicting determinations, Congress mandated, in

section 318 of the FPA, 16 U.S.C. § 825q, that where a company is subject to a requirement under PUHCA, it shall not be subject to regulation under the FPA with respect to the same subject matter.

In 1972 Ohio Power, confronting a rapidly growing need for environmentally compatible coal, contracted with an affiliate, Southern Ohio Coal Company (Southern Ohio), to develop certain coal mines in order to assure a reliable supply of high-btu, low sulfur coal for particular generating facilities. The transaction was approved by the SEC which, in compliance with the mandate of section 13(b) of PUHCA, 15 U.S.C. § 79m(b), required that the sale be made "at cost."

This case results from the refusal of the FERC to permit Ohio Power to recover in its wholesale rates the costs which it is obliged to pay pursuant to the SEC's order, limiting recovery instead to a lower hypothetical market price. On appeal, a panel of the United States Court of Appeals for the District of Columbia Circuit unanimously vacated the decision of the FERC. Two members of the panel based their decision upon the primacy given to the SEC's determination by section 318 of the FPA. Judge Mikva, while disagreeing with the majority's reading of section 318, concurred in the result: he held that the FERC was required, by its own regulations, to presume conclusively that all coal costs subject to the SEC's regulatory jurisdiction were reasonably incurred.

This case does not present an issue worthy of further review. Section 318 simply has not been a source of dispute. Prior to the decision below, the most recent decision construing that Section was issued more than a quarter century ago and the result there is entirely in harmony with that of the court below. Nor does the decision below conflict with that of any other circuit as to the deference to be accorded an agency's construction of a jurisdictional statute.

1. Statutory Scheme

The Public Utility Act of 1935, 49 Stat. 803, 15 U.S.C. §§ 79a *et seq.*, was a comprehensive legislative response to a growing concern over the dominance of public utility holding companies and the possibility that by their charging excessive prices to their utility affiliates for goods and services, consumers would be required to bear excessive electric rates.[1] Section 13(b) made unlawful contracts between associates of a public utility holding company unless they are performed under such "terms and conditions" as the SEC "by rules and regulations or order shall prescribe . . . to insure that such contracts are performed economically and efficiently for the benefit of such associated companies *at cost* . . ." 15 U.S.C. § 79m(b) (emphasis added). Since the concern about affiliate transactions was with their impact on electric rates charged consumers of utility affiliates, and because a companion enactment would expand the rate regulatory jurisdiction of the FERC's predecessor, the Federal Power Commission (FPC),[2] Congess recognized that conflicts could develop. Congress chose not to accept that risk. Instead, it explicitly resolved the "supremacy" issue by providing, in section 318 of the FPA, that when a person is subject to a requirement of PUHCA it shall not be subject to regulation under the FPA with respect to the same subject matter.[3]

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[1] See Federal Trade Commission, *Summary Reports on Utility Corporations*, pt. 72-A, p. 467, pt. 73-A, pp. 63-64 (1935). The reports that formed the factual basis of the 1935 Act have been called "some of the most exhaustive and comprehensive studies ever to underlie a federal statute." *North American Co.* v. *SEC*, 327 U.S. 686, 701 n.11 (1946).

[2] 16 U.S.C. §§ 824 *et seq.*

[3] Section 318 of the FPA provides in pertinent part:

> If, with respect to the issue, sale, or guaranty of a security . . . . *or any other subject matter*, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 or of a rule, regulation, or order thereunder and to a require-

2. The SEC's Review of Ohio Power's Coal Costs

Ohio Power is a wholly-owned subsidiary of the American Electric Power Company, Inc. (AEP), a regulated public utility holding company which provides electric service at wholesale and retail over a seven-state area through eight operating companies. In the early 1970's, AEP anticipated that low-sulfur coal, which would enable its generating plants to comply with new federal air emission standards, would become increasingly difficult and more costly to obtain. The urgency of these concerns was underscored by AEP's knowledge that it then had under construction or in the planning stage 15,500 megawatts of generating capacity, which would require an additional 32.5 million tons of coal annually. (Jt. App. filed in D.C. Cir., p. 85).

In 1971, the SEC authorized Ohio Power to create and to capitalize Southern Ohio, an affiliate, which would develop and operate coal mines. The SEC specifically provided that "[t]he charges for coal by Southern Ohio will be based on an amount *equal to the actual cost* of Southern Ohio in developing the reserve and mining such coal. . . ." *Ohio Power Co.*, Holding Company Act Release No. 17383 at 2 (Dec. 2, 1971) (emphasis added). Subsequently, in a series of additional orders, the SEC approved Ohio Power's sale of coal mines and leases to Southern Ohio, approved borrowings by Southern Ohio to reduce its cost of capital, approved further investments by Ohio Power in Southern Ohio to finance efficiency improvements in mining operations, and required both Ohio Power and Southern Ohio to file quarterly financial information and statements setting out "the quantities of

ment of this Act or of a rule, regulation, or order thereunder, the requirement of the Public Utility Holding Company Act of 1935 shall aply to such person, and *such person shall not be subject to the requirement of this Act*, or of any rule, regulation, or order thereunder *with respect to the same subject matter*.

16 U.S.C. § 825q (emphasis added).

coal sold to each buyer, the price of such coal and the method used to compute the cost of coal sold." [4]

3. The Administrative Proceedings

In 1982, the FERC initiated a rate proceeding pursuant to sections 205 and 206 of the Federal Power Act, 16 U.S.C. §§ 824d and 824e. All issues were settled except the extent to which Ohio Power could include its costs for "captive coal" purchased from Southern Ohio in its recoverable cost of service.

As the Administrative Law Judge (ALJ) found, "[b]y 1978 the Martinka mine [operated by Southern Ohio] was in commercial operation and it was decided to use the Martinka coal at Mitchell [an Ohio Power generating unit that had previously experienced operational problems due to poor quality coal] and the results have been very favorable." *Ohio Power Co.*, 25 FERC Rep. (CCH) ¶ 63,060 at 65,182 (1983). The higher quality coal enabled the generating unit to increase its effective availability from 62 to 74 percent, which produced savings to customers of 24 to 36 million dollars. The Administrative Law Judge referred to this evidence as "unchallenged." *Id.* at 65,194. Further, the Judge found that Ohio Power was prudent in acquiring rights to Martinka coal, that the Martinka mine has been "efficiently operated," *id.* at 65,201, and that the inclusion of such coal costs in Ohio Power's wholesale rates for the three years in question (1980 to 1982) was reasonable. *Id.* at 65,202-03.

The FERC reversed. It rejected Ohio Power's contention that the agency was required, either under section 318 of the FPA or its own rules, to give conclusive effect to the cost-based method of pricing affiliate coal transac-

[4] *Ohio Power Co.*, Holding Company Act Release No. 20515, 14 SEC Docket 928, 930 (April 24, 1978). *See also Southern Ohio Coal Co.*, Holding Company Act Release No. 21008, 17 SEC Docket 310 (April 17, 1979); *Southern Ohio Coal Co.*, Holding Company Act Release No. 21537, 19 SEC Docket 1309 (April 25, 1980).

tions mandated by the SEC. Instead, without questioning the finding that the mine had been efficiently operated, without even mentioning the benefits of assuring a long-term supply of high quality coal or the resulting savings realized by consumers, and dismissing as "fortuitous" the environmental benefits provided by the low-sulfur coal, the FERC directed Ohio Power to refund the difference between the cost-based price paid to Southern Ohio and a calculated hypothetical market price.

4. The Decision Below

The court below unanimously vacated the decision of the FERC. *Ohio Power Co.* v. *FERC*, 880 F.2d 1400 (D.C. Cir. 1989) (Pet. App., pp. 1a-28a). A majority of the panel rested its decision on statutory grounds. Noting that the FERC itself did not claim that its interpretation of section 318 was entitled to deference under this Court's decision in *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and its progeny, the majority found that such deference would not, in any event, be appropriate since section 318, unlike the statute at issue in *Chevron*, was not one entrusted to the FERC's administration. In apportioning jurisdiction between two federal agencies, that statute gave jurisdictional primacy to the SEC.

The court next rejected the FERC's rationale for concluding that section 318 is inapplicable: that the same "subject matter" was not implicated by the actions of the two agencies and, in any event, that the preclusive effect of section 318 was dependent on the existence of an actual conflict. Recognizing that the FERC has, in effect, set a different price term than had been set by the SEC for the cost of affiliate coal, the court found "[t]he conclusion that the same subject matter is implicated is inescapable." 880 F.2d at 1406 (Pet. App., pp. 9a-10a). Under the FERC's reasoning, the court observed, "there could never be a conflict between the SEC and FERC with respect to a matter not specifically enumerated in section 318" and it

was not inclined to render "the residuary language of section 318 meaningless." *Id.* (Pet. App., p. 10a). Further, the court noted that the objective of SEC regulation was not as limited as the FERC had surmised but, rather, included the charge that the SEC "exercise its power in the interest of consumers, as well as of investors and the public, and 'to insure that such contracts are performed *economically and efficiently*,' as well as 'at cost.' 15 U.S.C. § 79m(b) (emphasis added)." *Id.*

As to the necessity for actual conflict, the court concluded that it is sufficient, under section 318, that a person is subject to a requirement under PUHCA. *Id.* at 1408 (Pet. App., p. 14a). The court further found that the application of different standards by the FERC and the SEC to the same transaction in fact created a conflict, leading to the "trapping" of costs. *Id.* at 1410 (Pet. App., p. 18a). Cognizant of this Court's precedents that disfavor conflicting regulations resulting in trapped costs, *see, e.g., Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), the majority found that the market-based test adopted by the FERC would impermissibly create trapped costs when applied to transactions regulated by the SEC under an "at cost" standard.

Judge Mikva disagreed on the issue of statutory construction but agreed in a separate concurrence that the FERC's decision must be vacated for under the FERC's own regulation, 18 C.F.R. § 35.14(a)(7), there is a conclusive presumption that the costs of fuel purchased from an affiliated company which are subject to the jurisdiction of another agency are reasonable, and the FERC must abide by that agency's determination in its ratemaking decisions. The majority had no occasion to reach that issue.

REASONS FOR DENYING THE WRIT

I. Conflicts Between the SEC and the FERC Triggering Section 318 Occur Extremely Rarely

The decision of the court below will have no significant impact either upon the development of federal law or upon the FERC's administration of its ratemaking authority under the Federal Power Act. In the more than fifty years during which the SEC and the FERC have exercised their respective responsibilities under PUHCA and the FPA, only a handful of occasions have arisen presenting the potential for a conflict, and there is no reported case in the last quarter century in which either the FERC (or its predecessor) or the federal courts have even had occasion to construe the reach of section 318.[5] There is simply no reason for this Court to review the construction placed on a rarely-invoked federal statute, particularly when, as we show below, any other construction would have frustrated Congressional intent and made meaningless the regulations and orders issued by the SEC.

II. The Court Below Correctly Construed Section 318

The decision of the court below is eminently correct. The plain meaning of section 13(b) of PUHCA and section 318 of the FPA could hardly be more clear: utility purchases from affiliates are to be at cost, subject to the oversight of the SEC, and the FERC is precluded from exercising jurisdiction over the "subject matter" of those transactions. Congress entrusted the regulation of affiliate transactions to the SEC precisely to shield customers of holding company utility subsidiaries from excessive rates; specified the principle that those transactions be performed "at cost"; and having recognized the potential

[5] The SEC decisions cited by *amicus* Indiana Municipal Power Authority (Br., pp. 8-9) do not involve the construction of Section 318.

for conflict between the SEC and the FPC, resolved that issue directly and decisively in favor of the SEC.

1. Petitioners' claim that the majority's interpretation of section 318 creates a substantial "regulatory gap" is simply wrong. There is no gap, substantial or otherwise, because the SEC exercises plenary review over transactions between affiliates of a public utility holding company. As it did in this case, the SEC typically issues detailed orders specifying the components which may be included in the cost calculations. *See supra*, pp. 4-5 and n.4. Petitioners and the FERC may disagree with Congress' approach in PUHCA or with the SEC's application of that approach, but neither the FERC nor the courts are free to repudiate the clear direction of Congress.

This case does raise any issue concerning which federal agency has the authority to investigate whether a company providing goods or services to an affiliated utility within a holding company has been efficiently operated, so as to minimize the costs to be reflected in rates. The FERC's ALJ reviewed Southern Ohio's costs and concluded that the Martinka mine was "efficiently operated." 25 FERC Rep. (CCH) at 65,201. The FERC did not disturb this finding, but, rather, substituted an entirely different substantive standard for that employed by the SEC and mandated by Congress. The issue in this case is not the creation of a "regulatory gap"; the SEC regulates transactions between affiliates in holding companies. The issue is the FERC's attempted regulatory nullification of a substantive standard adopted by a sister federal agency, acting pursuant to clear statutory direction. The court below correctly rebuffed the FERC's attempt.

2. Petitioner's other major assertion is that the term "subject matter" in section 318 should be narrowly interpreted so that "the coal price charged to Ohio Power

by its affiliate is one 'subject matter,' and the coal-related fuel charge passed through to Ohio Power's customers is a separate 'subject matter.' " Cert. Pet., p. 13. The court below rejected this contention, and with good reason.

The SEC *never* regulates rates for the sale of electricity, a fact surely known to the Congress that entrusted that responsibility to the FERC. As the court below correctly found, the FERC's construction would render Section 13(b) of PUHCA pointless. Nothing of substance would be left of that section's "at cost" mandate if the public utility must base its charges to its customers as though the prices paid to its affiliate were determined on some other basis. Congress considered, but ultimately rejected, placing jurisdiction over transactions between holding company affiliates in the FPC.[6] Had Congress left jurisdiction with the FPC, could Petitioners seriously maintain that the FERC would be free to ignore its own decisions under PUHCA when setting rates under the FPA? Surely not. They are on no firmer ground in claiming that the FERC may disregard the determinations of the SEC.

3. As the majority below correctly recognized, its decision is butressed by this Court's recent precedents that disfavor conflicting regulation resulting in trapped costs. In *Nantahala Power & Light*, 476 U.S. at 970-71, the Court held that it was impermissible for a state utility commission setting retail rates to "trap" costs by making a different allocation between related companies of a fixed quantity of low-cost power than had the FERC at the wholesale level. A similar concern as to trapped costs led this Court to conclude in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 407 U.S. 354 (1988), that a state utility commission, when exercising its jurisdiction

[6] H.R. 5423, 74th Cong., 1st Sess. §§ 12(a)-12(d) (1935); S.1725, 74th Cong., 1st Sess. § 13(g) (1935). *See* H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7 (1935).

over retail rates, cannot inquire into the prudence of expenditures incurred during the construction of a nuclear plant from which a utility purchased power for resale when the FERC, in establishing wholesale rates, had allocated the cost of that plant among affiliated companies.

Petitioners erroneously assert that *Nantahala*'s "underlying principle" is "deference to FERC in ratemaking matters." Cert. Pet., p. 15 n.7. Rather, *Nantahala* and its progeny stand for the principle of deference to the agency with primacy over the cost determination. In *Nantahala* and *Mississippi Power & Light* the agency with primacy was the FERC; in this case, it is the SEC. Just as "a state's 'undoubted jurisdiction over retail rates' does not empower it to redetermine issues underlying FERC-set wholesale rates," 880 F.2d at 1406 (Pet. App., p. 10a), *quoting Nantahala*, 476 U.S. at 970, the FERC's undoubted jurisdiction over wholesale rates does not empower it to redetermine issues subject to the SEC's regulations and orders, issued under PUHCA. The District of Columbia Circuit faithfully adhered to the principles of *Nantahala* and *Mississippi Power & Light* in requiring that the FERC give effect to the SEC-imposed cost standard.

The panel's decision does not oust the FERC of jurisdiction over how costs are to be recovered in rates. So long as the FERC does not "trap" costs that the regulations or orders of the SEC says shall be recovered,[7] the FERC is free to exercise its plenary authority, just as state public utility commissions are free to exercise their plenary authority over retail rates, so long as they do not "trap" costs that the FERC says shall be recovered.[8]

[7] *Cf. California Oregon Power Co. v. FPC*, 150 F.2d 25 (9th Cir. 1945), *cert. denied*, 326 U.S. 781 (1946) (denying recovery of charges for affiliate transactions in excess of costs).

[8] Although the SEC has, in a variety of contexts, recognized that it does not have jurisdiction over the rates charged by utility subsidiaries of holding companies, *e.g.*, *Arkansas Power & Light Co.*,

4. The court below correctly rejected the contention that an actual conflict between the requirements imposed by the SEC and by the FERC is necessary for section 318's mandate of deference to the SEC to be invoked. 880 F.2d at 1408 (Pet. App., p. 14a). That conclusion is fully consistent with the decision of the Fourth Circuit in *Appalachian Power Co.* v. *FPC*, 328 F.2d 237 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964), although Petitoners contend otherwise. There, the court upheld an FPC order requiring a utility subsidiary of a holding company to maintain certain accounts on its corporate books. The court held that section 318 did not apply because "the SEC . . . does not require utilities to keep their books in accordance with its requirements." Indeed, the SEC by rule "explicitly excepted" the transaction from its accounting requirements and "specifically authorize[d] [adherence to] the FPC's uniform system of accounts." *Id.* at

Holding Company Act Release No. 18,750, 5 SEC Docket 24, 25 (1974); *New England Power Service Co.*, 10 S.E.C. 562 (1941), it has never indicated approval of the FERC's application of a different standard to transactions subject to the SEC's jurisdiction under PUHCA. To the contrary, the SEC staff has indicated that it is the FERC's role to apply an SEC order "to a particular rate case." Comments of the Division of Corporate Regulation of the SEC on the FERC Staff Preliminary Report of Investigation in FERC Docket No. E-9206, dated July 31, 1978, at 3 (Oct. 27, 1978). Further, the Chairman of the SEC informed Congress in 1982 that, as a result of section 318 and of the FERC's 1981 decision adopting a market-based test for non-PUHCA regulated transactions, *Public Service Co. of New Mexico*, 17 FERC Rep. (CCH) ¶ 61,123 (1981), *aff'd*, 832 F.2d 1201 (10th Cir. 1987), "that portion of the industry represented by the registered holding company systems is now subject to a different federal standard for determining affiliate transaction prices than that applied to the rest of the industry." *The Public Utility Holding Company Act of 1935: Hearings on H.R. 5220, H.R. 5465 and H.R. 6134 Before the Subcomm. on Energy Conservation and Power of the Comm. on Energy and Commerce*, 97th Cong., 2d Sess. 583 (June 9, 1982) ("1982 PUHCA Hearings"). This statement would be true only if the at-cost standard of section 13(b), as applied by the SEC, were reflected in wholesale rates.

250. Although the court used the phrase "actual conflicts," it is clear that the utility was not "subject to . . . a requirement of [PUHCA] or a rule, regulation or order thereunder" with respect to the subject matter of the FERC order and section 318 was therefore inapplicable.[9] Here, in contrast, the SEC's orders and its generally applicable regulations specify a standard to be applied to transactions between affiliates within holding companies.[10] Ohio Power is undeniably subject to a requirement under PUHCA with respect to its purchases of coal from Southern Ohio making section 318 applicable by its unambiguous terms.

Further, although the court below did not rest its decision on this ground, it also found that the application of an at-cost standard by the SEC and a comparable market standard by the FERC to the same transaction in fact

[9] *Accord Northwestern Electric Co.* v. *FPC*, 321 U.S. 119 (1944) (upholding FPC accounting order where Solicitor General informed the Court that Section 318 would not apply "[u]ntil the SEC does by rule or order impose 'requirements'" applicable to the situation at bar, Resp. Br., App. D. at 89-99). In *Appalachian Power*, the court observed:

> In sum, the effort to discover an incompatibility between the two governmental agencies must fail. The SEC does not in this litigation nor has it in any analogous context intimated such a conflict with the FPC. It has, in fact, repeatedly expressed a diametrically opposite view.

328 F.2d at 252. Here, to the contrary, the Chairman of the SEC has certainly "intimated such a conflict" (*see* 1982 PUHCA Hearings, *supra* n.8) and the regulations of the SEC render impossible any other judgment (*see infra*, n.10).

[10] The SEC's regulations, in 17 C.F.R. § 250.90, prohibit transactions between holding company affiliates "at more than cost," determined in accordance with 17 C.F.R. § 250.91, except as permitted by SEC order or regulation. 17 C.F.R. § 250.92 provides that a market test will be applicable to a sale of goods produced by a subsidiary of a holding company to an affiliate. Under the SEC's regulations, a market test, where applicable, is plainly an alternative to the at-cost test, rather than a supplement to it, as suggested by the FERC (Br. for Fed. Resp., p. 3).

created a conflict, leading to a trapping of costs. 880 F.2d at 1410 (Pet. App. p. 18a). The FERC asserted that its order permitted Ohio Power to recover a fair market value for coal purchased from Southern Ohio even if the market price exceeded the cost-based price paid to Southern Ohio, but the FERC "does not, and apparently cannot, explain how OPCO can recover in its rates such a fair market value in excess of cost without running afoul of the SEC's bar in 17 C.F.R. § 250.90(a)(2)." *Id.*

III. Petitioners' Complaints About the Statutory Scheme Should Be Addressed to the Legislative, Not the Judicial, Branch

Petitioners present a parade of horribles that they claim will result from the decision below: potential self-dealing between affiliated companies, rate manipulation, and the "unnecessary 'gold plating' of plant and equipment." Cert. Pet., p. 18. Such hyperbole provides scant reason for this Court to grant review. To begin with, more than fifty years of experience under PUHCA show such claims to be entirely unfounded. Moreover, to the extent that Petitioners are unhappy with the decision by Congress to give primacy to the SEC over inter-affiliate transactions, their remedy lies with the legislative branch, and not with the courts.

The short answer to Petitioners' parade of horribles is that one would expect, if Petitioners were correct, to have seen some evidence of these claimed abuses in the last fifty years. There is none. Pursuant to its mandate under PUHCA, the SEC must scrutinize the prices charged between affiliates of registered holding companies. As the court below correctly recognized, 880 F.2d at 1406 (Pet. App.. p. 10a), the SEC has statutory responsibility under PUHCA to exercise its power in the interests of consumers, as well as of investors, and "to insure that such contracts are performed *economically and efficiently*"

as well as "at cost." 15 U.S.C. § 79m(b) (emphasis added). If Petitioners are unhappy with the way that the SEC has been discharging its jurisdiction, they are free to challenge that exercise of regulatory authority directly. But dissatisfaction with the SEC's regulatory judgment does not provide a basis for the disregard of that judgment by the FERC.

In point of fact, the record below demonstrates that Southern Ohio operated the Martinka mine efficiently and that the affiliate transactions approved by the SEC resulted in substantial savings to rate payers. The use of high quality coal by Ohio Power, which it obtained from its investment in its affiliate's mining operations, increased the availability of the generating unit using the coal from 62 to 74 percent. As a result, taxpayers saved between 24 and 36 million dollars, according to the undisputed evidence. 25 FERC Rep. (CCH) at 65,194.

More fundamentally, Petitioners' claims are addressed to the wrong forum. Petitioners would prefer that the market-based test, which the FERC first adopted in its 1981 *Public Service Co. of New Mexico* decision for non-PUHCA regulated transactions, apply as well to transactions between affiliates of public utility holding companies. If such changes are desirable, then it is for the legislative branch to make them. Judicial intervention is particularly inappropriate as Congress has considered repealing or amending PUHCA (which would remove SEC jurisdiction over the transactions at issue here), and has declined to do so.[11] Indeed, in 1982, when Congress was specifically informed by the Chairman of the SEC that different standards were being applied by the SEC and the FERC for determining affiliate transaction prices (as a result of the FERC's 1981 decision in *Public Service Co. of New Mexico* and the SEC's enforcement of section 13(b) of PUHCA),[12] Congress chose not to modify the

[11] *See* 1982 PUHCA Hearngs, *supra* n.8.

[12] *Id.* at 582-83.

statutory scheme that has worked so well for the past fifty years. There is no reason for this Court to do so.

IV. The Application of the *Chevron* Deference Principle Is Not in Conflict With Decisions by Any Other Circuit

Petitioners contend that further review is required to resolve a conflict among the Circuits over the extent to which the principle of deference to an agency's construction of a statute that it administers, *see Chevron, USA, Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984), applies to jurisdictional statutes. This case does not present an appropriate vehicle to resolve any such conflict. As the Court held in *Chevron*, where "the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-43. As discussed, *supra* at pp. 8-9, that is precisely the circumstance here.

Second, the FERC itself did not contend in the court below that its construction of section 318 was entitled to deference. 880 F.2d at 1405 (Pet. App., p. 8a).

Third, the statutory issue aside, the decision of the court below can be affirmed on the alternative ground relied upon by Judge Mikva, namely, that FERC's own regulations require it to give conclusive effect in rate-making proceedings to the inter-affiliate fuel price determination made by the SEC.

Equally important, the decision below does not conflict with that of any other court of appeals over the application of the deference principle articulated in *Chevron*. The decisions of the First and Ninth Circuits cited by Petitioners involve the construction of a statutory provision which regulates the jurisdictional reach of a single federal agency. In each, the Circuit Court applied the *Chevron* deference principle in sustaining the agency's

construction. *See Kokajko* v. *FERC*, 873 F.2d 419 (1st Cir. 1989) (involving the FERC's construction of the scope of its jurisdiction under the FPA over hydroelectric power plants); *Wyckoff Co.* v. *EPA*, 796 F.2d 1197 (9th Cir. 1986) (involving the EPA's construction of its jurisdiction under the Resource Conservation and Recovery Act). Likewise, in *Puerto Rico Maritime Shipping Authority* v. *Valley Freight Systems, Inc.*, 856 F.2d 546 (3d Cir. 1988), the Third Circuit deferred to the Interstate Commerce Commission's construction of a jurisdictional statute governing the authority of that agency to regulate certain interstate shipments.

Whether these decisions correctly applied the *Chevron* deference principle to an agency's construction of its own jurisdictional statutes is essentially beside the point, for the statute at issue here is fundamentally different: it apportions jurisdiction between two agencies each of which is entrusted with responsibility to administer portions of a comprehensive, integrated statutory scheme.[13]

The decision of the court below not to give any special deference to the FERC's reading of section 318 also makes eminent sense. Any construction of that section by the FERC which broadened its authority would necessarily constrict the jurisdiction of the SEC, the agency given primacy by Congress. Congress recognized in section 318 that the regulatory structure must speak with one voice to avoid imposing conflicting requirements on regulated entities and it unequivocally gave that voice to the SEC, not to the FERC. In this circumstance, there is no reason for a court to defer to a construction placed on that section by the subordinate agency, which surely has no greater expertise as to the meaning of this conflict avoidance provision.

[13] *Puerto Rico Maritime Shipping Authority* did implicate the jurisdiction of the Federal Maritime Commission as well as that of the Interstate Commerce Commission, but it did not present a circumstance of shared responsibility.

CONCLUSION

This Court should deny the petition for writ of certiorari.

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IN THE

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OCTOBER TERM, 1989

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Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

In their petition, fifteen small villages and towns in Ohio (petitioners) explained that the decision of the District of Columbia Circuit incorrectly limited and failed to pay deference to the Federal Energy Regulatory Commission's (FERC) authority to review transactions between affiliates of a registered public utility holding company under Section 318 of the Federal Power Act. 16 U.S.C. 825q. The Solicitor General filed a brief for the federal respondent that agreed with petitioners' contentions and urged the Court to grant the petition. Respondent Ohio Power now opposes the grant of certiorari

by attempting to rewrite both the decision of the court of appeals in this case and the decision of the Fourth Circuit in *Appalachian Power Co.* v. *FPC*, 328 F.2d 237 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964), which squarely conflicts with the holding below. Ohio Power also raises a few additional points that warrant a brief response.

1. Obviously recognizing that the field preemption holding of the court of appeals is both wrong as a proper interpretation of Section 318 and important as a matter of federal policy with respect to the proper regulation of the rates charged for electricity, Ohio Power argues (Opp. 7) that the decision below was actually based on a "conflict" in the requirements imposed by FERC and the Securities Exchange Commission (SEC). In evaluating this argument, it is helpful to remember the exact language of the court of appeals: "We cannot accept [the FERC's] rationale . . . because it proceeds from a false premise that the bar of section 318 applies only when there is a present conflict between SEC and FERC prescriptions." Pet. App. 14a. In the face of that clear holding, it is frankly incredible for Ohio Power to maintain that the issue of field preemption is not actually presented by the decision below.

Nothing in the opinion supports Ohio Power's assertion (Opp. 7, 10, 13-14) that the discussion by the majority of "trapped costs" amounted to a holding that the FERC's decision "conflicts" with SEC regulations. Contrary to Ohio Power's argument, *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986) and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S.Ct. 2428 (1988), did not involve conflicts analysis. They were preemption of the field cases involving the filed rate doctrine. The discussion of trapped costs merely demonstrated how the state's nominally retail rate regulation in fact invaded the area of federal ratemaking which is the exclusive preserve of the FERC. Thus, aside from the complete irrelevance of those preemption

cases to a proper analysis of Section 318 (see Pet. 16), their use by the court of appeals in no way indicates that the decision below was based on an actual regulatory conflict.

The Solicitor General accurately described the status of the conflict issue as follows:

> Because the court of appeals did not reach the issue of whether in fact the SEC and FERC orders imposed conflicting requirements in this case, that issue would be open on remand.

SG Br. 13 n.6. In sum, the holding of the court of appeals is that under Section 318 the SEC's jurisdiction preempts the FERC's regulatory authority even without conflicting requirements. By not defending that holding, Ohio Power essentially concedes that the issue is worthy of review by this Court.

2. With respect to *Appalachian Power*, Ohio Power again engages in a revisionist interpretation of the holding of the court. While it may be, as Ohio Power contends, that the Fourth Circuit could have employed some other rationale for upholding the FERC's authority in that case, that fact does not change the court's holding that Section 318 did not apply because the SEC's jurisdiction is only preeminent when there are "actual conflicts." Again, it is appropriate to consider Ohio Power's claim in the context of the actual holding of the Fourth Circuit. "Under Section 318 of the Federal Power Act, actual conflicts between the FPC and the SEC are resolved in favor of the SEC," 328 F.2d at 250, but in that case, "the effort to discover an incompatibility between the two governmental agencies must fail." *Id.* at 252.

Nor is it a proper basis for denying certiorari that the issue has not arisen all that often. In light of the clear holding of *Appalachian Power* and the equally clear indications in *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944), that field preemption is not appropriate under Section 318, it is not surprising that the issue has

not arisen previously. But there can be little doubt that the new path charted for Ohio Power by the court of appeals will become well worn if the decision below is allowed to stand. While Ohio Power is willing to cast this consideration aside as mere hyperbole, a more neutral observer, the Solicitor General, found that "[p]etitioners reasonably catalogue the potentially far-reaching consequences of a decision that could hinder effective regulation of utilities. . . ." S.G. Br. 14.[1]

3. The court of appeals expressly held that FERC was not entitled to judicial deference in its interpretation of Section 318, which is a jurisdictional statute. Ohio Power contends (Opp. 16-18) that this holding does not conflict with decisions of other courts of appeals.

It is true that the holding can be narrowed to the issue of whether deference is owed to an agency's interpretation of a jurisdictional provision within the agency's organic statute that also implicates the regulatory authority of a second federal agency. But even on that issue, the decision here is in conflict with the approach of the Third Circuit in *Puerto Rico Maritime Shipping Authority* v. *Valley Freight Systems, Inc.*, 856 F.2d 546 (3d Cir. 1988), which involved the regulatory authority of two agencies. See Opp. 17 n.13. What is more important, however, is that the holding also poses the more basic question of whether deference is ever owed to an agency's interpretation of a jurisdictional provision. As

[1] It is no basis for denying certiorari that the policy concerns implicated by the decision of the court of appeals could properly be presented to Congress or that Congress has occasionally considered abolishing PUHCA. Opp. 15. Petitioners in fact presented this issue to precisely the correct forum—the FERC—which is empowered to administer the Federal Power Act. FERC correctly held that Ohio Power's rates were unreasonable because of the rates charged for affiliate transactions. To the extent that "[j]udicial intervention is particularly inappropriate" (Opp. 15), it is not with respect to action by this Court to reinstate FERC's decision; instead, it was the intervention of the D.C. Circuit in setting aside FERC's rate determination.

we explained in the petition (Pet. 9-14), that issue is clearly one that warrants a decision by this Court. See also *Dole* v. *United Steelworkers*, 58 U.S.L.W. 4200, 4207-4208 (Feb. 21, 1990) (White, J., dissenting). And respondent does not dispute that claim.

4. Ohio Power also disagrees with the observation of Judge Mikva, the Solicitor General and petitioners that the decision below creates an erroneous regulatory gap in the setting of electric utility rates. Yet, Ohio Power admits that "[t]he SEC *never* regulates rates for the sale of electricity" (Opp. 10). Nor does Ohio Power dispute the SEC's own holding that it has "no power" over the dealings of electric utilities "with their customers, retail or wholesale", which are regulated under PUHCA. *American Elec. Power Co.*, 46 S.E.C. 1299, 1323 (1978).[2] See also Pet. 19. Nor does it dispute that the SEC, unlike FERC, has no customer complaint procedures and no express authority to order refunds for overcharges. See *id.* Accordingly, there can be no serious question that the court of appeals' decision leaves substantial gaps in the federal regulatory system, gaps that were not and could not have been intended by Congress.

[2] This is the complete answer to Ohio Power's repeated attempts to suggest, without really saying so, that the SEC in this case actually *required* Ohio Power to pass the coal costs at issue here onto its customers. See Opp. 2, 4, 5-6, 9, 11. The SEC never imposed any such requirement, and Ohio Power cites no evidence that it did.

Ohio Power also makes repeated references to SEC approvals of its "transactions." Opp. 2, 4, 5-6, 9. It is worth noting that the SEC never reviewed and approved any specific price for any coal sold by Southern Ohio Coal Company to Ohio Power. It approved general transactions with a requirement that all coal be sold "at cost" which includes both actual cost and a return on investment. Moreover, actual costs include salaries that can be bloated and other items which may be extravagant. Pet. 3-4. Thus, by approving a general transaction that contains a "cost" provision, the SEC in no way imposes any requirement on the price of coal that is in conflict with the FERC's order rejecting Ohio Power's rates.

5. Finally, Ohio Power, relying upon the administrative law judge's findings, which were set aside by the FERC, attempts to persuade the Court that its transactions with the Southern Ohio Coal Company actually served the public interest. Opp. 5, 15.[3] While not crucial to the worthiness of the questions presented for review, the claim is incredible in light of the uncontested findings that Ohio Power passed on prices for coal in the rates charged to petitioners that were between 24 and 94 percent above market price and that justified to refunds of approximately $10 million to wholesale customers. Thus, under the FERC's findings, the transactions at issue served only Ohio Power's interests and not the public good.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

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[3] Ohio Power's reliance (Opp. 5) upon findings of the ALJ based upon evidence that the mines were operated "efficiently" is misleading. That evidence was not contested by petitioners before the ALJ because under the FERC's market-price test such proof is irrelevant. Pet. App. 43a-44a, 71a. The market price standard is an objective one that does not permit the utility to justify above market prices on the basis of factors such as efficiency. *Id.* Thus, the findings of the ALJ in no way detract from the clear holding of FERC that the coal prices in Ohio Power's rates paid by petitioners were excessive.

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BRIEF OF THE INDIANA MUNICIPAL POWER AGENCY AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONERS

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QUESTIONS PRESENTED

1. Whether the lower court erroneously failed to accord any deference to agency interpretation of a statutory scheme, where

   (a) the scheme consists of two statutes (the Federal Power Act or FPA and the Public Utility Holding Company Act or PUHCA), administered by two agencies (the Federal Energy Regulatory Commission or FERC and the Securities and Exchange Commission or SEC, respectively), which function together to regulate interstate public utility holding companies; and

   (b) the lower court's ruling as to the jurisdiction of each agency is inconsistent with the manner in which both agencies have interpreted and administered the relevant statutory provisions since the FPA and PUHCA were enacted more than half a century ago.

2. Whether the lower court erroneously interpreted FPA Section 318 and PUHCA Section 13(b), through misapplication of preemption principles and this Court's decision in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), in holding that the FERC is without jurisdiction to ensure that a public utility holding company's rates include only just and reasonable payments made to affiliated suppliers of fuel and other goods and services used to produce electricity, even when the SEC has not scrutinized or determined the affiliated supplier prices.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1283

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF THE INDIANA MUNICIPAL POWER AGENCY AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONERS

The Indiana Municipal Power Agency (IMPA), pursuant to Rule 37 of the Rules of the Supreme Court of the United States, hereby submits this brief as *amicus curiae*, in support of the "Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit," filed on February 9, 1990, by Arcadia, Ohio, *et al.* (the Petition for Certiorari).[1]

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[1] Letters of consent from the parties below are being filed with the Court simultaneously with the filing of this *amicus* brief.

PARTIES TO THE PROCEEDINGS

The parties to the proceeding are set forth in the Petition for Certiorari.

OPINIONS BELOW

The majority and dissenting opinions of the Court of Appeals are reproduced at pages 1a-28a of the Appendices to the Petition for Certiorari (Pet. App.), and reported at 880 F.2d 1400 (D.C. Cir. 1989). The decision of the Federal Energy Regulatory Commission (FERC) is reported at 39 F.E.R.C. ¶ 61,098 (1987) (Pet. App. pp. 31a-67a), and the FERC's decision denying rehearing is reported at 42 F.E.R.C. ¶ 61,046 (1988) (Pet. App., pp. 68a-73a).

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

AUTHORITIES INVOLVED

Section 318 of the Federal Power Act or FPA, 16 U.S.C. § 825q, is set out in the Petition for Certiorari (page 2). Other statutory provisions at issue are FPA Sections 205 and 206, 16 U.S.C. §§ 824d and 824e, and Section 13(b) of the Public Utility Holding Company Act or PUHCA, 15 U.S.C. § 79m(b). These provisions are reproduced in the Statutory Appendix to this brief.

INTEREST OF THE INDIANA MUNICIPAL POWER AGENCY

IMPA was formed as a political subdivision of the State of Indiana, pursuant to Indiana Code 8-1-2.2, to serve as an electric power supply and planning agency for municipalities which own and operate retail electric distribution systems. IMPA currently consists of 29 Indiana cities and towns.[2] IMPA is a wholesale electric

[2] The members of IMPA are the cities and towns of Anderson, Bainbridge, Bargersville, Centerville, Columbia City, Covington, Crawfordsville, Darlington, Edinburgh, Flora, Frankfort, Frankton, Greendale, Greenfield, Jamestown, Lawrenceburg, Lebanon, Linton, Middletown, Paoli, Pendleton, Peru, Renssalaer, Richmond, Rising Sun, Scottsburg, Tipton, Washington and Waynetown, Indiana.

customer of Indiana Michigan Power Company (I&M), which is an operating company subsidiary of the American Electric Power Company, Inc. (AEP). AEP is a registered public utility holding company subject to the jurisdiction of the Securities and Exchange Commission (SEC). I&M's wholesale rates to IMPA are subject to the jurisdiction of the FERC.

The opinion below addressed the respective jurisdictions of the FERC and the SEC with regard to the regulation of the cost of fuel purchased by another operating company subsidiary of the AEP system, Ohio Power Company (Ohio Power), from its fuel subsidiary. The panel majority concluded that Section 318 of the FPA deprives the FERC of jurisdiction to apply a market-price test to payments made by Ohio Power to its fuel subsidiary in determining the justness and reasonableness of Ohio Power's electric rates, through which Ohio Power sought to pass the cost of those payments to its wholesale electric customers.

Inter-affiliate transactions can be a significant component of the costs of a public utility holding company. For example, AEP, through its operating companies, has invested not only in affiliate coal mining operations, but in related fuel supply equipment and facilities, including a fleet of river towboats, approximately 500 coal barges, more than 3000 rail-hopper cars for transporting coal, and a rail-to-barge coal transfer terminal on the Ohio River with the capacity of transferring in excess of 12 million tons of coal annually. As a customer of an operating company subsidiary of a registered public utility holding company, IMPA has a direct interest in preventing the imposition of unwarranted restrictions upon the exercise by the FERC of its jurisdiction to regulate

the wholesale electric rates of such operating company subsidiaries for the protection of consumers.

STATEMENT OF THE CASE

IMPA adopts the statement in the Petition for Certiorari.

REASONS FOR GRANTING THE PETITION

I. Summary

In the opinion below, the majority vacated a decision of the FERC, reached after a full adjudicative hearing and on the basis of an extensive record, disallowing in Ohio Power's wholesale rates a portion of the payments made to its affiliated coal supplier, because the price of that coal substantially exceeded the market price available from non-affiliated suppliers. The FERC concluded that this disallowance was necessary to ensure that Ohio Power's rates were just and reasonable, pursuant to Sections 205 and 206 of the FPA, 16 U.S.C. §§ 824d and 824e, relying on its previous determination [3] that a market-price test promotes economic efficiency and protects against the possibility of self-dealing among affiliates.

Pursuant to its authority under PUHCA, the Securities and Exchange Commission (SEC) had previously issued several orders regarding Ohio Power's coal affiliate. The FERC examined those orders and concluded that they were not inconsistent with disallowance of higher-than-market costs in Ohio Power's rates. 39 F.E.R.C. at pp. 61,276-78 (Pet. App., pp. 36a-40a). Judge Mikva, in his dissenting opinion, agreed. 880 F.2d at 1411-12 (Pet. App., pp. 21a-23a). *See also* the majority opinion, 880 F.2d at 1404, 1408-09 (Pet. App., pp. 5a-6a, 15a). The majority, however, held that FPA Section 318 di-

[3] *Public Service Co. of New Mexico*, 17 F.E.R.C. 61,123 (1981), *aff'd*, 823 F.2d 1201 (10th Cir. 1987).

vested the FERC of jurisdiction over this "subject matter" even if there was no conflict between the SEC and FERC orders. Because PUHCA Section 13(b) authorizes the SEC to regulate certain aspects of inter-affiliate holding company transactions in goods and services, the court concluded that Congress intended that the SEC have sole jurisdiction of prices paid by public utilities *and their ratepayers* for fuel and other goods and services supplied by affiliates,[4] when the utilities are members of registered public utility holding companies subject to PUHCA (unless the SEC has exempted the transaction in question from the requirements of Section 13(b)). The majority's reasoning apparently was that FPA Section 318 divests the FERC of jurisdiction to disallow or adjust for ratemaking purposes costs incurred pursuant to a transaction over which PUHCA gives the SEC some regulatory authority.

IMPA respectfully submits that the majority's holding requires this Court's review for two reasons. First, the lower court disregarded not only the FERC's interpretation of FPA Section 318, but also the *SEC's* interpretation of that provision and of PUHCA Section 13(b). Second, the lower court's ruling is not only clearly erroneous, but also distorts the law established by this Court in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and does substantial violence to the regulatory system that Congress established and two agencies have implemented over half a century, to protect investors and consumers from abuses of interstate public utility holding companies.

II. The Decision Below Upsets 50 Years of SEC and FERC/FPC Decisionmaking

The lower court concluded that it should not defer to the FERC's interpretation of FPA Section 318 because

[4] Other than electricity, which is exempted from SEC regulation by PUHCA Section 2(a)(20), 15 U.S.C. § 79b(a)(20).

what was at issue was that agency's jurisdiction. 880 F.2d at 1405 (Pet. App., p. 8a). However, the lower court's action was more serious than this characterization might suggest. The court disregarded the interpretation of FPA Section 318 and PUHCA Section 13(b) that has consistently been employed by *both* agencies entrusted by Congress with administering the statutes it enacted simultaneously in 1935: the FERC (and its predecessor, the Federal Power Commission or FPC) *and* the SEC. In so doing, the lower court disrupted a regulatory system that those agencies have developed over the last half century.

The FERC's view that its mandate to ensure just and reasonable rates includes the power and the obligation to scrutinize holding company inter-affiliate payments is not of recent vintage. Prior to the development of the market-price test that was applied to Ohio Power, the FERC's predecessor, the FPC, disallowed for ratemaking purposes excessive payments made by public utilities to supplier affiliates. The FPC's "no profits to affiliates" rule was applied to operating utilities within holding company systems, even though their transactions with affiliated service companies and fuel suppliers were regulated by the SEC under PUHCA. *E.g., California Oregon Power Co. v. FPC*, 150 F.2d 25, 27-28 (9th Cir. 1945), *cert. denied*, 326 U.S. 781 (1946).[5]

The conclusion of the majority below that SEC pronouncements are consistent with ousting the FERC of jurisdiction over holding company affiliate fuel purchases is incorrect. In numerous orders, stretching from the 1940's through the 1980's, the SEC has acknowledged

[5] The FPC originally developed the "no profits to affiliates" rule in the early 1930's, in regulating hydroelectric licensees under the Federal Water Power Act of 1920 (now Part I of the FPA). After the enactment of the FPA and PUHCA in 1935, the FPC applied this rule to the regulation of interstate electric utilities. *California Oregon Power Co. v. FPC*, 150 F.2d at 27.

FPC/FERC jurisdiction to scrutinize costs incurred by public utilities pursuant to intra-holding company transactions subject to SEC jurisdiction under PUHCA, at least in the absence of a conflict between the FPC's or FERC's actions and a specific SEC ruling pertaining to the cost in question.

In *Central and South West Fuels, Inc.*, Holding Company Act Release No. 23,876, 34 SEC Docket 500 (October 23, 1985), the SEC considered a proposal by electric utility subsidiaries of the Central and South West Corporation to dissolve a fuel subsidiary and transfer its functions to the service company for the holding company system. In response to a concern expressed by intervenors that inflated fuel prices might result, the SEC expressly acknowledged the FERC's continuing jurisdiction:

> [N]othing in the proposed transactions will alter the statutory and regulatory pricing restrictions applicable to the sale of fuel to, or the performance of services for, affiliated operating companies. Such restrictions will continue to apply . . . as fully as they have applied . . . in the past. For example, Rules 90 and 91 [promulgated under PUHCA] limit charges for sale or services by an affiliated company to cost; Paragraph E of Section 23.23 of the Substantive Rules of the Public Utility Commission of Texas expressly limits affiliate fuel pricing to cost; and similarly, with respect to wholesale rates, under Section 35.14 of the regulations of FERC, unreasonable fuel charges by affiliated companies may result in the suspension of the fuel adjustment clause or cause an investigation by FERC on its own motion.

34 SEC Docket at 503. In approving requests in the 1940's by Ohio Power and an affiliated public utility to establish a coal subsidiary, the SEC noted that its actions did not preclude ratemaking authorities from scrutinizing the transactions in question for purposes of setting rates.

Appalachian Electric Power Co., 27 S.E.C. 1029, 1034-35 (1948).[6] *Accord, The North American Co.*, 29 S.E.C. 521, 537 n.26 (1949) (in ruling that a holding company could retain its coal subsidiary, SEC noted that coal prices would be scrutinized by ratemaking authorities, and added that it could take action under Section 13 and other provisions of PUHCA at a later date if necessary). *See also New England Power Service Co.*, 10 S.E.C. 562, 571 (1941) (in investigating the relationship between the service company and two operating utility subsidiaries of a registered holding company, the SEC examined the holding company members' rates to test the system's efficiency, but observed that "the propriety of the rate itself [is] a matter over which this Commission has no jurisdiction . . .").

In the proceeding below, the FERC relied on SEC statements in *New England Electric System*, Holding Company Act Release No. 22,309, 24 SEC Docket 298 (December 9, 1981). The lower court distinguished this case on the grounds that the SEC's discussion of the FERC's authority may have been predicated on the grant of an exemption under PUHCA Section 13(b). 880 F.2d at 1407 (Pet. App., pp. 12a-13a). This reading is incorrect. The SEC concluded that, because FERC's ratemaking jurisdiction is *independent* of PUHCA, no harm to consumers would result from a grant of exemption from PUHCA Section 13(b). 24 SEC Docket at 307-08, quoted at 39 F.E.R.C. at pp. 61,277-78 (Pet. App., pp. 39a-40a).

In other decisions, the SEC has observed that its jurisdiction over financing vehicles under PUHCA does not operate in conjunction with FPA Section 318 to divest the FERC or state ratemaking agencies of their authority to disallow the related costs in setting just and rea-

[6] The SEC added that it had the authority, under PUHCA Section 13, to take further action in the future if it determined that such action was necessary to enforce the standards of PUHCA or to protect consumers or investors. 27 S.E.C. at 1035.

sonable electric rates. *E.g., Arkansas Power & Light Co.*, Holding Company Act Release No. 18,442, 4 SEC Docket 395, 397 (June 4, 1974) (SEC approval of a sale and leaseback of nuclear fuel does not bind retail rate agencies or the FPC to allow the cost of the fuel in rates); *Georgia Power Co.*, Holding Company Act Release No. 18,750, 5 SEC Docket 24, 25 (December 31, 1974) (SEC approval of a partial sale of a nuclear plant by an operating utility subsidiary of the Southern Company does not prevent rate commissions from scrutinizing the reasonableness of the sale price under FPA Section 318). In considering how a refinancing of a holding company operating utility subsidiary should be treated in the ratemaking system of accounts, the FPC held that FPA Section 318 did not divest it of jurisdiction in the absence of SEC action. *Oklahoma Gas and Electric Co.*, 5 F.P.C. 52, 54 (1946). The SEC, expressing a desire to avoid conflicts with the FPC and state ratemaking authorities, approved the same accounting treatment approved by the FPC, although it was somewhat at odds with general SEC policy. *Oklahoma Gas and Electric Co.*, 22 S.E.C. 209, 219 (1946), and 22 S.E.C. 466 (1946).[7] Although these cases do not involve PUHCA Section 13(b), they are inconsistent with the lower court's reading of FPA Section 318, because they establish that the SEC has not interpreted its jurisdiction to be exclusive even over "subject matters" that are expressly enumerated in FPA Section 318 (accounting, se-

[7] Similarly, when the SEC has exercised its regulatory powers under PUHCA regarding corporate and financial holding company system restructurings, it has always assumed that the FERC/FPC has the authority to scrutinize those same transactions with regard to how they affect the reasonableness of wholesale rates and interstate electric utility operations. *E.g., Sierra Pacific Resources*, Holding Company Act Release No. 24,566, 40 SEC Docket 103, 109 (January 28, 1988), *aff'd, Environmental Action v. SEC*, No. 88-7132 (9th Cir. filed February 9, 1990); *Georgia Power Co.*, Holding Company Act Release No. 23,330, 30 SEC Docket 934, 935-36 (June 15, 1984).

curity issuances, and acquisition and disposition of securities, assets and facilities).

Judicial deference to an agency's interpretation of a statute that it administers is grounded in the principle that a reviewing court should not interfere with the authority delegated to the agency to develop the details of an administrative scheme and to develop policy within the parameters set by Congress. *Chevron USA v. Natural Resources Defense Council*, 467 U.S. 837, 843-44 (1984). Whatever the merits of judicial deference to an agency's interpretation of its statutory jurisdiction in an ordinary case, the lower court's action in the case at bar was extraordinary. The majority's ruling disrupts a regulatory system fashioned by two agencies over a 50-year period, in which the SEC, in exercising its powers under PUHCA, generally has deferred to and relied upon the FERC's or FPC's power, in setting rates, to disallow costs incurred by operating utility subsidiaries of holding companies as unjust and unreasonable. Moreover, the FERC's and SEC's longstanding implementation of FPA Section 318 and PUHCA Section 13(b) is entirely consistent with the plain meaning of those statutes.

III. The Decision Below Does Violence to the Statutory Scheme and Distorts This Court's Prior Holdings

The lower court rested its decision that the FERC was divested of jurisdiction to disallow payments made by Ohio Power to its coal subsidiary, even in the absence of any conflicting SEC order, on an extremely broad and unreasonable reading of FPA Section 318 and PUHCA Section 13(b). Analogizing to the doctrine of "preemption of the field," which has been applied to bar state regulation of a subject matter which Congress intended be subject only to federal regulation, the lower court concluded that Congress intended to divest a *federal* agency, charged with ensuring just and reasonable electric rates, of jurisdiction over an important aspect of rates (intra-holding company transactions in fuel and other goods and services used to produce electricity), simply by enacting PUHCA Section 13(b) and FPA Section 318. This conclusion is contradicted by the very fact that in 1935 Congress established a scheme to regulate interstate electric utilities that consisted of *two* statutes and *two* agencies, with interlocking and complementary powers.[8] FPA Section 318 was necessary to resolve any actual conflicts that might arise between the two agencies. There is no reasonable basis to read that provision, together with PUHCA Section 13(b), as a complete withdrawal of jurisdiction from the FERC of an important element of rates. Congress addressed the general scope of the FERC's jurisdiction over interstate utility rates and services in Section 201 of the FPA (18 U.S.C. § 824), not in Section 318. *See, e.g.*, Section 201(b)(1) (no jurisdiction over generating or distribution facilities or purely intrastate transmission facilities), and Section 201(f) (no jurisdiction over the United States, or a state, or any political subdivision of a state).

The notion that FPA Section 318 divests the FERC of jurisdiction of any "subject matter" regulated by the SEC under PUHCA cannot be squared with this Court's ruling in *Northwestern Electric Co. v. FPC*, 321 U.S. 119 (1944). In that case, the Court rejected a challenge to an FPC order requiring a holding company operating utility subsidiary to reclassify, in the ratemaking system

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[8] The D.C. Circuit has explained this scheme as one giving the SEC principal authority over utility corporate structure and financing, and the FERC (foremrly the FPC) principal authority over interstate utility operations and rates. *City of Lafayette v. SEC*, 454 F.2d 941, 954-56 (D.C. Cir. 1971), *aff'd on other grounds, Gulf States Utilities Co. v. FPC*, 411 U.S. 747 (1973). This Court quoted the *Lafayette v. SEC* analysis of the allocation of authority between the SEC and the FERC/FPC in *Gulf States Utilities Co. v. FPC*, 411 U.S. at 754-55 n.4.

of accounts, $3.5 million of capital stock to eliminate an over-valuation of the utility's assets. In response to an argument that the FPC's order was inconsistent with the SEC's authority and regulations, the Court concluded that "an examination of the statute and of the orders and proceedings of the [SEC] satisfies us that no conflict exists." 321 U.S. at 125. Although *Northwestern Electric* did not involve PUHCA Section 13(b), it did involve a "subject matter" specifically identified in FPA Section 318—"the method of keeping accounts"—which is subject to SEC regulation under PUHCA and FERC/FPC regulation under the FPA. *See Appalachian Power Co. v. FPC*, 328 F.2d 237 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964).

As pointed out by the dissent (Pet. App., p. 30a), the decision below creates a serious regulatory gap in the system designed by Congress and implemented by the FERC and the SEC. The majority observed that Ohio Power's coal costs had not been scrutinized or controlled by the SEC. 880 F.2d at 1408-09 (Pet. App., p. 15a). However, the gap is more serious than the lower court acknowledged. The SEC's orders regarding Ohio Power are no anomaly. As discussed above, the SEC has frequently declined to closely scrutinize inter-affiliate costs, because it has assumed that they would be scrutinized by the FERC (and state commissions) in the context of rate proceedings. Even more important, as the Petitioners noted, the SEC lacks the statutory and administrative procedures to hear complaints regarding excessive rates, and also appears to lack the authority to provide retroactive relief from excessive charges (Petition for Certiorari, p. 19). In rejecting a "preemption of the field" analysis regarding regulation of rural electric cooperatives by state authorities, when the FERC had declined to regulate those entities, this Court observed that "Congress' purpose in 1935 [in enacting the FPA provisions regarding regulation of interstate electric utilities] was to fill a regulatory gap, not to perpetuate one." *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 384 (1983) (footnote omitted). By divesting the *federal* agency entrusted with interstate electric rate regulation of jurisdiction over an important element of the rates of those utilities who belong to interstate holding company systems, the lower court created an outcome even more unreasonable than that rejected by the Court in *Arkansas Electric Cooperative Corp.*

The regulatory gap threatened by the decision below is much wider than the specific holding. Although the court only purported to consider the wholesale ratemaking jurisdiction of the FERC, its analysis would appear to divest state commissions of jurisdiction over this aspect of retail rates. The majority relied on a "preemption of the field"-type analysis of PUHCA Section 13(b) in its interpretation of FPA Section 318. In so doing, the court claimed to be relying on the principles articulated in *Nantahala Power & Light Co. v. Thornburg*, and, in particular, on this Court's analysis of the problem of "trapped costs." However, state commissions are not preempted by *Nantahala v. Thornburg* from disallowing in retail rates the costs of an electric utility or natural gas pipeline other than costs incurred pursuant to a FERC-regulated rate paid to a supplier of wholesale electricity or natural gas. The costs which *Nantahala* ruled should not be "trapped" by a state comission in retail rates are wholesale electricity or gas costs borne by a utility pursuant to an interstate transaction approved as just and reasonable by the FERC. 476 U.S. at 969-970, 971-72. *Accord, Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 108 S.Ct. 2428, 2438-39 (1988). Thus, the decision below incorrectly applies this Court's ruling in *Nantahala*, to the detri-

ment of many millions of consumers served by holding company systems.[9]

With regard to FERC as well as state regulation of rates, the lower court's reliance on the *Nantahala* "trapped costs" principle is misplaced. Ohio Power did not experience any "trapped costs", in the sense of costs mandated by the SEC under PUHCA and disallowed by the FERC under the FPA. The FERC and the dissenting judge below reviewed the SEC orders touching on Ohio Power's purchases from its coal subsidiary, and concluded that there was no conflict with the action taken by the FERC (Pet. App., pp. 21a-23a, 36a-37a, 61a-62a). The majority disregarded this analysis, because it concluded that Ohio Power should be protected against even the possibility of trapped costs. This conclusion, however, is inconsistent with Congress' decision to delegate to *two* agencies the task of regulating interstate public utility holding companies to protect investors and consumers from the abuses which were paramount in the minds of the drafters of the Federal Power and Public Utility Holding Company Acts of 1935.

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[9] In the decisions cited in the previous section, the SEC has repeatedly declared that state retail rate commissions as well as the FERC are free to scrutinize inter-affiliate costs of holding company systems to protect ratepayers from excessive charges. *E.g., Central and South West Fuels, Inc.*, 34 SEC Docket at 503; *Georgia Power Co.*, 5 SEC Docket at 24; *Arkansas Power & Light Co.*, 4 SEC Docket at 397; *Appalachian Electric Power Co.*, 27 S.E.C. at 1034-35.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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March 1, 1990

STATUTORY APPENDIX

STATUTORY APPENDIX

SECTION 318 OF THE FEDERAL POWER ACT, 16 U.S.C. § 825q

Conflict of jurisdiction

If, with respect to the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 [15 U.S.C.A. § 79 et seq.] or of a rule, regulation, or order thereunder and to a requirement of this chapter or of a rule, regulation, or order thereunder, the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this chapter, or of any rule, regulation, or order thereunder, with respect to the same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this chapter shall apply to such person.

SECTION 13(b) OF THE PUBLIC UTILITY HOLDING COMPANY ACT, 15 U.S.C. § 79m(b)

Contracts by subsidiary or mutual service companies

(b) After April 1, 1936, it shall be unlawful for any subsidiary company of any registered holding company or for any mutual service company, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, to enter into or take any step in the performance of any service, sales, or construction contract by which such company undertakes to perform services

or construction work for, or sell goods to, any associate company thereof except in accordance with such terms and conditions and subject to such limitations and prohibitions as the Commission by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies. This provision shall not apply to such transactions as the Commission by rules and regulations or order may conditionally or unconditionally exempt as being necessary or appropriate in the public interest or for the protection of investors or consumers, if such transactions (1) are with any associate company which does not derive, directly or indirectly, any material part of its income from sources within the United States and which is not a public-utility company operating within the United States, or (2) involve special or unusual circumstances or are not in the ordinary course of business.

SECTION 205 OF THE FEDERAL POWER ACT, 16 U.S.C. § 824d

Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, or classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time

when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, tc the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; definition

(1) Not later than 2 years after November 9, 1978 and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

SECTION 206 OF THE FEDERAL POWER ACT, 16 U.S.C. § 824e

Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the

Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest

Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the refund effective date or by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, whichever is earlier, the Commission shall state the reasons why it has

failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order the public utility to make refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: *Provided*, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; "electric utility companies" and "registered holding company" defined

Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be

paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: *Provided*, That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission's order. For purposes of this subsection, the terms "electric utility companies" and "registered holding company" shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C.A. § 79 et seq.].

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

Supreme Court, U.S.
FILED
MAY 25 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-1283

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PETITION FOR WRIT OF CERTIORARI FILED FEBRUARY 9, 1990
CERTIORARI GRANTED MARCH 26, 1990

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FEDERAL ENERGY REGULATORY COMMISSION

RELEVANT DOCKET ENTRIES

Accession No.	Date	Proceedings
8208310540	5/28/82	Suppl. 12 to Elec. Rate Schedule 18 of OH Power Co.: SVC to Wheeling Elec. Co.
8206010174	5/28/82	OH Power Co. Revised Tariff Sheets to Tariff MRS. Comparative Billing Analysis, Testimony & Annual Rpt. included
8206100205	6/09/82	Notice that on 5-28-82 OH Power Co. File Charges in Rate Schedule 18
8306030145	6/01/83	Transcript of 830601 Hearing Held at Washington, D.C. Re OH Power Co., pp 9-198
8306080415	6/02/83	Transcript of 830602 Hearing Re OH Power, pp 199-367
8306080422	6/03/83	Transcript of 830603 Hearing Re OH Power Co., pp 368-496.
8306090407	6/06/83	Transcript of 830606 Hearing Re OH Power Co., pp 497-707
8306080561	6/07/83	Transcript of OH Power Co. 830607 Hearing in Washington, D.C. pp 708-900
8306130199	6/08/83	Transcript of 830608 Hearing Held in Washington, D.C. Re OH Power Co., pp 901-1078
8306140487	6/09/83	Transcript of OH Power Co. 830609 Hearing in Washington, D.C., pp 1079-1211
8312190251	12/14/83	Initial Decision by Presiding Law Judge

Accession No.	Date	Proceedings
8402220006	2/21/84	Brief on Exceptions in the Matter of OH Power Co.
84002220058	2/21/84	Commission Staff Brief on Exceptions to Initial Decision in re OH Power Co.
8402230092	2/21/84	Brief on Exceptions of Municipal Wholesale Elec. Customers of OH Power Co. to Initial Decision of Administrative Law Judge
8402230085	2/21/84	Forward Brief on Exceptions of Municipal Wholesale Elec. Customers of OH Power Co. re ER-82-553-000 & ER-82-554-000
8403210197	3/19/84	Forwards Brief of OH Power Co. Opposing Exceptions to D.W. Miller, Presiding Administrative Law Judge Initial Decision
8403210338	3/20/84	Forwards Brief of Municipal Elec. Customers of OH Power Co. Opposing Exceptions re: Subj. Dockets
8403210360	3/20/84	Forwards Staff Brief Opposing Exceptions to Initial Decision Re OH Power Co.
8403210198	3/20/84	Brief of OH Power Co. Opposing Exceptions to D.W. Miller, Presiding Administrative Law Judge, Initial Decision
8403210342	3/20/84	Brief of Municipal Wholesale Elec. Customers of OH Power Opposing Exceptions Re: Subj. Dockets
8403220031	3/20/84	Commission Staff Brief Opposing Exceptions to Initial Decision re: Ohio Power
8705080024	4/30/87	Opinion and Order on Ohio Power Co. Recovery of the Cost of Coal Purchased from an Affiliate

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

RELEVANT DOCKET ENTRIES

DATE	FILINGS—PROCEEDINGS
04-15-88	5-Petitioner's petition for review of an order of the FERC (m-15)
04-15-88	Clerk's order that the initial submissions and procedural motions due 05/16/88; dispositive motions due 05/30/88.
04-15-88	Certified copy of above order and petition for review was mailed to respondent(s).
05-16-88	5-Petitioner's docketing statement and initial submissions, deferred appendix-yes (m-16) (11 & 22)
05-16-88	CERTIFIED INDEX TO RECORD
05-16-88	5-Motion of New England Power Company for leave to participate as amicus curiae (m-16)
05-18-88	5-Motion for leave to intervene of the Municipal Wholesale Electric Customers of Ohio Power Co., time having expired (m-10) (11)
05-16-88	5-Motion for leave to intervene of LCP Chemicals & Plastics, Inc. Mobay Corp., Olin Corp., and PPG Industries, Inc. (m-13) (11)
05-26-88	5-Response of Ohio Municipal Customers opposing motion of New England Power for leave to participate as amicus curiae (m-26) (11) (6) (23)
07-14-88	Clerk's order granting all motions for leave to intervene.
08-11-88	Per Curiam order granting motion of New England Power Company for leave to participate as amicus curiae. Robinson, Silberman and D.H. Ginsburg, CJs

DATE	FILINGS—PROCEEDINGS
08-24-88	Clerk's order that this case has been scheduled for oral argument on Friday, Feb. 24, 1989 at 9:30 a.m. before Circuit Judges Mikva, Silberman and Sentelle. The following schedule shall apply: Petitioner's Brief—Oct. 28, 1988; Amicus Curiae in support of Petitioner—Nov. 16, 1988; Respondent's Brief—Dec. 19, 1988; Intervenor's Brief in support of Respondent—Jan. 6, 1989; Petitioner's Reply Brief, if any and Intervenor's Reply Brief in support of Petitioner—Jan. 24, 1989; Deferred Appendix—Jan. 31, 1989; and Final Briefs—Feb. 7, 1989. Briefs must be delivered to the Clerk's office by the date indicated to be considered timely filed. A further order of the Court will be issued regarding allocation of time for argument.
10-26-88	7-PETITIONER'S BRIEF (Ohio Power Company) (m-26)
11-08-88	5-Motion of New England Power Company to withdraw as amicus curiae (m-7) [8]
11-14-88	Per Curiam order granting motion of New England Power Company to withdraw as amicus curiae. The Clerk shall note the docket accordingly.
11-16-88	8-Errata sheet for Petitioner's—Ohio Power Company—Brief. (M-16)
12-19-88	7-Respondent's Brief. (M-19)
01-06-89	7-Intervenors' Brief. (M-6)
01-24-89	8-REPLY BRIEF FOR PETITIONER (m-24) [25]
01-31-89	7-Joint Appendix Volumes 1 & 2. (M-31) (6-25)
02-01-89	7-Errata to joint appendix. (6-25) (m-1)
02-07-89	15-FINAL Intevenors' brief. (M-7) (6-25)
02-07-89	15-FINAL Respondent's brief. (M-7) (6-25)

DATE	FILINGS—PROCEEDINGS
02-07-89	15-FINAL Petitioner's Brief. (M-7) (6-25)
02-07-89	15-FINAL Petitioner's Reply Brief. (M-7) (6-25)
02-17-89	Clerk's order, sua sponte, that the following times are allotted for the oral argument: Petitioner —15 min.; Respondent—15 min. Respondent may share time with intervenor.
02-24-89	ARGUED before Circuit Judges Mikva, Silberman and Sentelle. Inactive Bin No.
07-28-89	Opinion for the Court filed by Circuit Judge Sentelle.
07-28-89	Concurring opinion filed by Circuit Judge Mikva.
07-28-89	Judgment by this Court that the petition for review is granted, the order of the Commission is vacated, and the case is remanded, all in accordance with the Opinion for the Court filed herein this date.
07-28-89	Mandate order.
09-11-89	20-Petition for Rehearing and Alternative Suggestion for Rehearing En Banc Submitted by Intervenor Ohio Municipals (m-11) [1]
09-11-89	20-Petition of the FERC for Rehearing and Suggestion for Rehearing EN BANC (m-11) [1]
09-12-89	5-Respondent's motion for leave to substitute corrected copies of petition for rehearing. (M-12) (1)
09-15-89	Per Curiam order granting respondent's motion for leave to file substitute copies of petition for rehearing.
09-15-89	20-Petition of the FERC for rehearing and suggestion for rehearing *en banc*. (M-11) Filed per above order. (1)

DATE	FILINGS—PROCEEDINGS
10-12-89	Per curiam order denying respondent's and intervenor's (Ohio Municipals) petitions for rehearing. Judge Mikva would grant petitions; his statement attached to order. Mikva, Silberman and Sentelle, CJs
10-12-89	Per curiam order, en banc, denying respondent's suggestions for rehearing en banc. CJ Wald, Mikva, Edwards, Ruth B. Ginsburg, Silberman, Buckley, Williams, D.H. Ginsburg and Sentelle, CJs
01-24-90	MANDATE ISSUED.
01-04-90	Notice from Clerk's Office, U.S. Supreme Court that the Chief Justice signed an order extending the time for filing writ of certiorari to and including 2/9/90 [1]
03-27-90	Letter from US Supreme Court Clerk's Office dated 3/26/90 forwarding Supreme Court order dated 3/26/90 allowing certiorari. [1]

FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. ER82-553-000 and ER82-554-000

OHIO POWER COMPANY

INITIAL DECISION

(Issued December 14, 1983)

David W. Miller, Presiding Administrative Law Judge

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VII. Ultimate Determination .....

Appearances

Edward J. Brady, Marcia I. Resnick, Alan Kessler and *William E. Olson* for Ohio Power Company

William H. Roberts and *Richard E. Hitt* for Public Service Commission of West Virginia

Paul Nordstrom, Glen L. Ortman and *Kenneth E. Natale* for Municipal Wholesale Customers of Ohio Power Company

Philip Nelson and *O. C. Hall* for Wheeling Electric Company

James D. Kauffelt for Linden Chemicals and Plastics, Inc., Mobay Chemical Corporation, Olin Corporation, PPG Industries, Inc. (Industrials)

Melvin Berger, Arthur Hays Butler, Lawrence R. Greenfield, Michael Small and *James E. Rogers, Jr.*, for the Staff of the Federal Energy Regulatory Commission

I. Background

On May 28, 1982, the Ohio Power Company (OPCO) submitted for filing increased rates in Docket No. ER82-553-000 for service to fifteen municipalities located in Ohio, and in Docket No. ER82-554-000 for service to its affiliate, Wheeling Electric Company. By order issued July 23, 1982, the Commission accepted the rates for filing to become effective on December 28, 1982, for service to the fifteen municipalities, and on July 29, 1982, for service to Wheeling Electric Company, both subject to refund, and consolidated the dockets for hearing and decision. *Ohio Power Company*, 20 FERC ¶ 61,081 (1982).

In response to OPCO's filing in Docket No. ER82-553-000, the Villages of Arcadia, Bloomdale, Carey, Cygnet, Deshler, Greenwich, Ohio City, Plymouth, Republic, Shiloh, Sycamore, Wapakoneta and Wharton, and the Cities of Bryan and St. Clairsville, Ohio (Municipals), filed a petition to intervene. In Docket No. ER82-554-000, the industrial customers of Wheeling Electric Company, namely, Linden Chemicals and Plastics, Inc., Mobay Chemical Corporation, Olin Corporation, and PPG Industries, Inc. (Industrials), petitioned to intervene. The Public Service Commission of West Virginia (WVPSC) also filed a timely Notice of Intervention. The Commission's order of July 23, 1982, granted all the interventions.

Settlements of all matters except for what was termed the captive coal issue were filed in both dockets, and were accepted by Commission orders dated May 18, 1983, and July 8, 1983, respectively. *Ohio Power Company*, 23 FERC ¶ 61,236 (1983), *Ohio Power Company*, 24 FERC ¶ 61,017 (1983).

Hearings were held on the captive coal issue on June 1-9, 1983, and on July 12-13, 1983 (transcript pages 9-1529); post-hearing briefs were filed and considered.

In brief, the Staff, supported by the Municipals and WVPSC, contends OPCO has included roughly $20 million too much in its annual cost-of-service because the coal it purchased from a wholly-owned subsidiary, Southern Ohio Coal Company, which was mined at the Martinka mine, exceeded by that amount what comparable non-affiliate coal could have been purchased for. Staff Initial Brief, page 2; WVPSC Initial Brief, page 9; Municipals Initial Brief, page 4. Of this $20 million, roughly $2 million is allocable to customers under FERC jurisdiction. OPCO Initial Brief, page 11.

In brief, OPCO states its position by posing three questions, each of which it would answer in the negative (OPCO Initial Brief, pages 1, 2):

(1) Can the Commission impose a market price standard here since the price paid for the Martinka coal is regulated by the Securities and Exchange Commission (SEC) and the Public Utilities Commission of Ohio (OPUC)?

(2) Has the Commission adopted a broad policy mandating that affiliated coal supplies be treated as presumptively unreasonable and subject to automatic adjustment to the level of a hypothetical market price?

(3) Assuming an affirmative answer to question (2), has Staff met its burden of showing it used an appropriate methodology?

II. Factual Setting

A. *Corporate Relationships and Use of Martinka Coal at Mitchell Plant*

The America Electric Power Company (AEP) is a large, public utility holding company which provides electric service at wholesale and retail over a seven state area, through eight principal subsidiary operating companies (Exh. 15, page 6):

> Appalachian Power Company, Columbus and Southern Ohio Electric Company, Indiana & Michigan Electric Company, Kentucky Power Company, Kingsport Power Company, Michigan Power Company, Ohio Power Company, and Wheeling Electric Company.

Ohio Power (OPCO) provides electric service in eastern, east central, southern, and northwestern Ohio. Exh. 1, pages 3-4. Wheeling Electric provides electric service in northern West Virginia and has no generating facilities of its own. Exh. 15B, page 1. Wheeling Electric purchases all of its power from OPCO. Id.

OPCO has three subsidiary companies actively engaged in the mining of coal. Exh. 15, page 6. One of these, Southern Ohio Coal Company (SOCCO), currently operates coal mines in both Ohio and West Virginia. Id. The West Virginia coal mine—the Martinka mine—is a deep mine located in Marion County, West Virginia, near the town of Fairmont. Id; Exh. 4A, pages 4-5, 14.

Coal from the Martinka mine is transported by rail to and burned at OPCO's Mitchell generating plant located along the Ohio River near Captina, West Virginia. Exh. 15, page 7. *See* Exh. 15G for locations of the Mitchell plant and Martinka mine. The delivered cost of coal from the Martinka mine consists of the cost of coal at the Martinka mine plus the cost of transporting the coal from the Martinka mine to Mitchell. Exh. 15, page 11; *see* Exh. 15H which is a copy of the sales contract between SOCCO and OPCO at page 4. The cost of coal at the Martinka mine includes full recovery of all costs plus a return on the capital invested in the mine. Exh. 4, page 22.

Coal for OPCO's generating plants, all of which are coal-fired, is procured not by OPCO but by the Fuel Supply Department of the American Electric Power Corporation (AEPSC), the management, professional, and technical service company for the AEP system. Exh. 15, page 7. The service company is charged with procuring fuel for all of AEP's subsidiary operating companies, including OPCO. Id. The service company is responsible not only for procuring coal from non-affiliated mines but also is responsible for the operation of AEP's and, hence, OPCO's affiliated mines. Id. AEP is the nation's largest single purchaser of coal. Id. at 10. In calendar year 1981, AEP consumed some 41.6 million tons of coal and OPCO's own generating plants consumed some 14 million tons of coal. Id. at 10.

B. *Mitchell Plant*

Mitchell has two coal-fired units, each with a nameplate capacity of 800 MW. Exh. 2, pages 5-6. Because of problems with a Westinghouse generator, unrelated to the coal being burned, Mitchell Unit No. 1 is currently rated at only 660 MW. Id. at 6.

Mitchell Unit No. 2 has a history of being unavailable due to coal-related causes almost twice as often as another plant, Amos 1, which went in service at the same time as Mitchell 2, in 1971. Exh. 32E, page 3. Amos 1 and Mitchell 2 are virtually identical units whose operations are distinguished only by the coal quality used at each unit. Tr. 256; Exh. 2, pages 5, 6.

After a study completed in April 1977, the Hall Report (Exh. 32E), which made the comparison of the Amos 1 and Mitchell 2 units, extensive tests were conducted to determine if the quality of the Consolidated Coal Company's McElroy coal which was being used in Mitchell

2 could be improved to a satisfactory level; when the tests proved negative, the decision was made to phase out the McElroy coal on the Mitchell units and replace it with a higher quality coal. Exh. 2, page 7. The change in fuel quality began in 1980 and, while there was not an instantaneous change, there has been an improvement in the forced outage rate at Mitchell 2. Tr. 278-79; Exh. 26.

Michael B. Doherty, Assistant Manager, Steam Generation Section, Plant Engineering Division, American Electric Power Service Corporation (AEPSC), testified that the Mitchell units are dry bottom boilers and as such perform more efficiently with coals having ashes with high melting temperatures. Exh. 3, page 9. He said "[u]ncontrolled slagging occurs when large amounts of molten ash occur in units where there is no mechanism built into the unit's design for its removal. This "[,in his view,] is the fundamental problem associated with using a wet bottom coal in a dry bottom unit such as has occurred at Mitchell." Id. In short, the McElroy coal which was used in the Mitchell units starting in 1971 until it was decided to upgrade the quality of coal used there in 1980 to Martinka coal was the cause of the excessive downtime in Mitchell 2 when compared to Amos 1. Id. at 40-45. Until 1978 the amount of McElroy coal received and burned at Mitchell did not exceed approximately 45% of the total burn on an annual basis. Id. at 41. The distinction between wet and dry bottom boilers refers to the method by which slag is removed from the boiler; slag on the boiler's floor is either in a molten or dry state. Id. at 9. A wet bottom boiler requires a coal with ash having a relatively low fusion temperature. Id at 9.

As to the scope of the slag problems in the Mitchell units, Mr. Doherty had personally observed slag and ash accumulations as much as 30-feet high, 14-feet wide and 40-feet across; although this is an extreme example, smaller accumulations, only the size of a pickup truck, have occurred on other occasions. Exh. 3, page 33.

C. Martinka Mine

The original basic coal supply for the Mitchell Generating Station was the McElroy mine which was planned and developed by the Consolidated Coal Company under contract. Exh. 4, pages 15, 16. The contract was dated December 30, 1966, with deliveries scheduled to begin on May 31, 1971, for a term of twelve (12) years. Id. at 16. When it was found that the operating results and characteristics of Mitchell did not even begin to compare with the operating results of nearly identical units at the Amos Generating Station, it was determined that the McElroy high sulfur, low ash fusion temperature coal could not be burned in Mitchell's boiler without creating slagging problems and advancing boiler tube erosion. Id. at 17. Rather than abandon use of the favorably priced McElroy coal, and in light of OPCO's contractual commitments for that coal, OPCO experimented with the McElroy coal to see what could be done to accommodate it in Mitchell's boilers. Id. at 17. By 1978 it became apparent the efforts to improve the quality of the McElroy coal used at Mitchell had not been successful. Id. at 17.

By 1978 the Martinka mine was in commercial operation and it was decided to use the Martinka coal at Mitchell and the results have been very favorable. Exh. 4, page 18. The background to the Martinka mine is a lease agreement between OPCO and the owners of the coal reserves in 1972. Id. This was a low sulfur supply of coal, and it was expected at that time that low sulfur eastern coal would become increasingly difficult to obtain. Id. at 19. OPCO considers the Martinka mine as fully developed and forecasts a production of 2.0 million tons of clean coal in 1983 at an average FOB mine cost of $38.81 per ton. Id. at 19, 20. Except for aberrations caused by labor strikes and difficult mining conditions the FOB mine costs for Martinka have been steadily improv-

ing on a constant dollar basis; the numbers are (id. at 20):

Years	*Actual Selling Price ¢/MBtu*	*Constant 1977 Dollars ¢/MBtu*
1977	152.1	152.1
1978 *	195.8	181.8
1979	204.5	170.6
1980	168.3	123.7
1981 *	246.3	163.9
1982	183.2	114.9

* Impacted by the UMWA strike

The Btu and sulfur content of Martinka coal in 1980-82 was about 11,800 Btu and 1.5% sulfur. Exh. 15P, Schedules 1, 2 at pages 12, 13 respectively; Exh. 15KK, page 12.

III. Significance of Securities and Exchange Commission (SEC) and Public Utilities of Ohio (OPUC) Regulation

A. Concerning the SEC Exclusive Jurisdiction Contention

1. OPCO Position

There is a conflict of jurisdiction between the Commission and the SEC. The price OPCO pays for coal from Southern Ohio's Martinka mine is set by a formula applied by the SEC under the Public Utility Holding Company Act of 1935 (1935 Act), 15 U.S.C.A. §§ 79a, *et seq.* In such a situation, Section 318 of the Federal Power Act, the Conflict of Jurisdiction provision, applies, and this Commission's jurisdiction over the pricing of OPCO's coal purchases from its affiliate must give way to the SEC's jurisdiction. OPCO Initial Brief, page 5.

2. Staff Position

OPCO seeks to manufacture a conflict with the SEC where none in fact exists. Put simply, the SEC's regulations do not require affiliate prices to be set at cost or equal to cost. They speak of "at not more than cost," and "does not exceed a fair and equitable allocation." OPCO, although free to charge up to cost, is also equally free to charge less than cost. Staff Reply Brief, pages 27, 28.

Section 318 also does not apply because this proceeding does not involve the "same subject matter" as the SEC's regulation. While the SEC regulates the price paid to the affiliate Martinka coal mine by Ohio Power, the Commission, in contrast to the SEC, is only interested in the price of affiliate Martinka coal as a cost the utility passes through its rates to ratepayers. In short, the SEC does not set rates while this Commission does. Staff Reply Brief, page 30.

3. West Virginia Public Service Commission Position

The rules promulgated by the SEC do not require a holding company subsidiary to price its service to be provided or a good to be sold by it at its cost. WVPSC Reply Brief, page 3. Rather, this service must be provided or the good sold at *no more than cost.* (17 C.F.R. § 250.90(a)(2).) Id. Moreover, if the holding company subsidiary actually produces the goods to be sold, those goods shall not be sold to an associate company "at a price which exceeds the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere . . . ." (17 C.F.R. § 250.92(b).) Id. at 3, 4.

The FERC's authority *to establish rates* for sales of electric energy at wholesale in interstate commerce should be recognized as separate and distinct from the SEC's authority *to apportion costs* among public utility holding company affiliates, WVPSC Reply Brief, page 5.

4. Municipals Position

In general the Municipals asserted positions similar to those advanced by the Staff and WVPSC. Municipals Initial Brief, pages 67,69-71; Municipals Reply Brief, pages 9-15, 18-24, 27-28.

To the best of the Municipals' knowledge, the SEC does not as a matter of course issue orders approving AEP's quarterly statements regarding affiliate coal, and has never issued an order specifically approving the price of Martinka coal. Municipals Reply Brief, page 16.

5. Discussion and Conclusion

The st .rting point for OPCO's position is Section 318 of the Federal Power Act which provides:

> Sec. 318. If, with respect to the issue, sale, or guaranty of a security . . ., *or any other subject matter*, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 . . . and to a requirement of this Act . . . the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this Act, . . . *with respect to the same subject matter*, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this Act shall apply to such person. [Emphasis supplied.]

Assuming, *arguendo*, that SEC sets a price which Southern Ohio can charge OPCO for the Martinka coal, is that the "subject matter" which Section 318 refers to? If the SEC was dealing with "just and reasonable rates" for OPCO's jurisdictional customers, obviously the same "subject matter" would be involved. However, it appears SEC is regulating in a broad sense the relationship between the holding company and all its subsidiaries so that no one of the associated companies takes advantage of any other. The section of the Public Utility Holding Company Act of 1935 which OPCO cites as showing the "subject matter" SEC is acting toward is Section 13(b) reading in part:

> [I]t shall be unlawful for any subsidiary company of any registered holding company . . . to . . . sell goods to, any associate company thereof except in accordance with such terms and conditions and subject to such limitations and prohibitions as the [SEC] . . . by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies.

This language does not indicate SEC's subject matter in setting coal prices is the "just and reasonable" rates to be charged to OPCO's customers.

In conclusion, SEC, at the most, is regulating the sale of coal between Southern Ohio and OPCO for purposes of keeping a reasonable arm's-length relationship between the two associated companies, whereas the FERC is regulating the sale of electricity by OPCO to its customers. The subject matters are entirely different, and the "Conflict of Jurisdiction" provision of the Federal Power Act does not preclude the Commission from deciding what the "just and reasonable" rates are to be in this case, and in particular the proper amount to be allowed in the cost-of-service for the use of Martinka coal by OPCO.

OPCO asserts that the taking clause of the Fifth Amendment of the United States Constitution would be violated if the SEC and the Commission attempt to regulate the same subject matter and in so doing apply different standards, that is, the SEC a cost-of-service standard and the Commission a market price standard. OPCO Initial Brief, pages 8, 9; OPCO Reply Brief, pages 31-32. Absent the actual implementation of different standards so as to cause a taking of property it would be difficult to determine if the mere existence of the standards by

themselves would be unconstitutional. *See Hodel v. Virginia Surface Mining Reclamation Association, Inc.*, 452 U.S. 264, 294-95 (1981). In other words the constitutionality *vel non* of different standards could depend upon how the different standards are applied. But even if in implementation of different standards OPCO was limited in how its property could be used, for example, it could only sell to third parties at a profit, this type regulation is not necessarily violative of the Fifth Amendment. Most regulations limit the use of property in some way and yet do not result in a constitutional taking of property. For example, *see Andrus v. Allard*, 444 U.S. 51, 65 (1979), and cases discussed in Gelin and Miller, *The Federal Law of Eminent Domain* (1982), pages 55-67. Since the decision here does not find any basis for disallowing any part of the payments made for the Martinka coal it isn't necessary to rule on this claim.

B. Concerning the Effect of OPUC and SEC Establishing a Price for Martinka Coal in Conjunction with 18 C.F.R. 35.14(a)(7)

1. OPCO Position

18 C.F.R. 35.14(a)(7) reads in part: "Where the utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and includable in the adjustment clause." The "fuel cost adjustment clause" must conform to the principles set out in 18 C.F.R. 35.14 or it is not in the public interest. The fuel clause is to be in a form that provides for periodic adjustments per kWh of sales equal to the difference between the fuel cost per kWh of sales in the base period and in the current period. 18 C.F.R. 35.14(a)(1).

Staff has consistently recognized that regulation of affiliate fuel transactions by the SEC or by a state commission is sufficient to satisfy the rule's requirements and trigger its operation. OPCO Initial Brief, page 136. The

price charged to OPCO for Martinka coal is regulated both by the SEC and the Ohio Public Utility Commission (OPUC). OPCO Initial Brief, pages 137, 141.

2. Staff Position

Section 35.14(a)(7) of the Commission's regulations does nothing more than establish a rebuttable presumption that, in the absence of a showing to the contrary, fuel prices subject to another agency's regulatory jurisdiction are reasonable. This is borne out by Section 35.14(a)(10) of the Commission's regulations, which provides that the Commission may waive any part or all of its fuel adjustment clause regulations, including Section 35.14(a)(7). Staff Reply Brief, page 37. Furthermore, Section 35.14(a)(7) can no longer be considered a bar to this Commission's review of Ohio Power's affiliate coal prices in light of the subsequent passage of Section 208 of the Public Utility Regulatory Policies Act of 1978 (PURPA). 16 U.S.C. § 842d(f) (Suppl. II 1978.) Id. at 41.

It would be inappropriate for the Commission to defer to the SEC as to the reasonableness of affiliate coal prices; the SEC is not guided by the same statutory standards as is the Commission and the interests protected by the SEC are not necessarily the same interests protected by the Commission. Staff Reply Brief, page 48. This Commission has an independent obligation under the Federal Power Act to ensure that rates are just and reasonable. 16 U.S.C. §§ 824d(a), 824(e) (1976). Id. at 50.

Although the Public Utilities Commission of Ohio has jurisdiction over Ohio Power's retail rates and the allowance of costs that are to be recovered in those rates, it has no authority over the price actually charged by Southern Ohio Coal Company to Ohio Power. Staff Reply Brief, page 51. Section 35.14(a)(7) requires that state regulatory authority must encompass the price paid for coal sold by the affiliate coal mine to the utility. Id. at 53.

3. West Virginia Public Service Commission Position

The Wheeling Electric Company should not be forced to pay rates which include excessive affiliated coal costs. This is a decision that is appropriate for either the West Virginia Commission or the FERC—it is definitely not one to be made by the Public Utilities Commission of Ohio pursuant to Rule 35.14(a)(7). WVPSC Initial Brief, page 7. The West Virginia Commission has historically repriced the affiliated coal of Appalachian Power Company and Virginia Electric and Power Company whenever the cost of that coal exceeds the cost of non-affiliated coal. Id.

4. Municipals Position

In general, the Municipals take positions similar to those of the Staff. Municipals Initial Brief, page 66-72.

The Public Utility Commission of Ohio does not and cannot exercise regulatory authority over OPCO's coal investments similar to that which it or the FERC exercise over OPCO's utility operations. Municipals Reply Brief, page 32. It does not and cannot conduct a cost of service analysis of Southern Ohio's coal operations and therefore is incapable of determining whether Southern Ohio's costs are reasonably incurred under a cost-based standard; alternatively, it has not employed a market-based standard. Id. To the extent the Commission relies on the Ohio Commission's limited authority to regulate OPCO's recovery of Martinka coal costs on the retail side, it fails to protect the interests of the Municipals and OPCO's other FERC jurisdictional customers and to ensure that OPCO recovers only costs reasonably incurred. Id.

5. Discussion and Conclusion

Although it is possible to read the language of 18 C.F.R. 35.14(a)(7) as OPCO does, it is also possible to read it as the Staff does. Consequently the interpretation

made by Federal Power Commission Chairman John N. Nassikas in the letter of May 15, 1975, to the Senate Subcommittee (Appendix E to the Staff's Reply Brief) is important. That letter speaks of the regulation as creating a presumption of reasonableness. Letter at page 15. Chairman Nassikas' interpretation is consistent with the obligation placed upon the Commission to regulate wholesale rates within a certain sphere and the Commission's rejection of efforts by State commissions to establish wholesale rates in interstate commerce either directly or indirectly. *E.g., Western Massachusetts Electric Company*, 23 FERC ¶ 61,345. It is noted that OPCO in its Initial Brief, page 137, refers to 35.14(a)(7)'s presumption of reasonableness.

Staff's argument that SEC is not regulating in the sense of 18 C.F.R. 35.14(a)(7) is at odds with the language of 35.14(a)(7), specifically the reference to prices for fuel purchases which is precisely what SEC regulates. The Staff argument that OPUC, like FERC, is regulating the rates rather than specific elements going into the rates is more persuasive. If important, which it isn't here, this argument would require further analysis before a conclusion could be reached as to the consequences of an OPUC finding that the Martinka prices are reasonable. Since SEC uses the cost-of-service regulation approach to the Martinka coal prices, at least to the extent that SEC actually applies that approach, 18 C.F.R. 35.14(a)(7) would be applicable. It isn't clear that SEC has in fact ever monitored the cost-of-service claims made with respect to the Martinka coal and before the presumption of reasonableness provided by 18 C.F.R. 35.14(a)(7) would come into play it would be necessary to have more information on this point. However, the situation would be no different here whether or not 35.14(a)(7) had created such a presumption. The serious doubt Staff created in its presentation cancels out any such presumption and brings into play the burden of proof rules discussed hereafter in Part V.

Even if OPCO's position was accepted *vis-a-vis* the Public Utility Commission of Ohio's actions respecting the Martinka coal, there is no reason to bind the West Virginia customers by the Ohio Commission actions. The position of the West Virginia Public Service Commission is sound.

IV. Precedential Effect of Commission Opinion No. 133

A. OPCO Position

Accepting, *arguendo*, that the Commission has jurisdiction to adjust the cost-of-service price paid for the Martinka coal, and that it has not already decided the price set by SEC is reasonable under its own regulations, the Commission decision in *Public Service Company of New Mexico*, Opinion No. 133, 17 FERC ¶ 61,123 (1981), did not establish a broad principle that a cost-of-service approach should be abandoned and a market price approach used in all cases where the appropriateness of the transfer price of affiliate coal is brought into issue. OPCO Initial Brief, pages 147-48.

B. Staff Position

Commission precedent mandates the use of a market price standard to judge the reasonableness of affiliate coal prices. Staff Initial Brief, page 12.

C. Discussion and Conclusion

1. History of Opinion No. 133

An Initial Decision preceding Opinion No. 133 was issued January 25, 1980 (10 FERC ¶ 63,020). One issue was the "costs related to 'captive' coal (*i.e.*, that coal purchased from a subsidiary enterprise) for the cost-of-service treatment." *Id.* at 65,142. The coal was purchased by Public Service Company of New Mexico (PNM) from a 50%-owned subsidiary, Western Coal Company (WCC). *Id.* at p. 65,142. PNM had placed in its cost-of-service

the price paid to WCC, and that price was considered to be the market price. Staff urged that WCC should only be paid what WCC's cost-of-service would justify, and that this price would be below the so-called market price. Judge Harfeld decided that the market standard methodology should be used instead of the cost-of-service approach urged by Staff. *Id.* at 65,143. This decision dealt with a locked-in-period, and before it was passed upon by the Commission the parties entered into a settlement agreement. However, Judge Harfeld considered the "captive coal" issue again respecting a later PNM rate filing in an Initial Decision issued November 28, 1980 (13 FERC ¶ 63,041), and affirmed his earlier holding. Id. at p. 65,171. This later Initial Decision was affirmed, in pertinent part, by the Commission in Opinion No. 133.

Since, as noted hereafter, the Commission not only affirmed Judge Harfeld's conclusion but also approved his reasons, the reasoning found in his decisions are reviewed.

Judge Harfeld reasoned in the first Initial Decision (10 FERC ¶ 63,020) that the affiliated coal supplier should not be treated as a public utility and required to earn the identical rate of return on common equity as the parent company; adoption of a strict cost-of-service test to determine the price the affiliated coal supplier could charge its parent would likely discourage coal affiliation with electric utilities; the same incentives should be given to the development of coal supplies as are given for the exploration and production of natural gas by pipeline affiliates, and legal precedent in natural gas cases supports the use of a market standard for testing the reasonableness of the price of fuel charged by an unregulated wholly-owned gas pipeline subsidiary to its regulated electric utility parent—the court reasoned that not permitting the gas pipeline subsidiary to charge its parent the market price could lead the parent to buy gas elsewhere and cause the subsidiary to sell its gas on the market; the Commission has a standard of "prudent cost incur-

rence" for testing expenses incurred by a regulated company. Within the legal framework of "prudent cost incurrence" Judge Harfeld decided that the "proper test [in the case before him] is a market approach comparing the contract coal price with prevailing market coal prices to determine whether these coal costs were prudently incurred." 10 FERC at p. 65,144. Judge Harfeld also noted that the market test is consistent with the Commission's policy respecting non-jurisdictional shipping charges in liquefied natural gas import proceedings where corporate affiliation existed between the regulated importer or the interstate pipeline hiring the ships and the non-regulated shipping company; in particular he quotes from a Commission order that states: "If the rate paid here is comparable with rates charged for the same or similar services by this or any other shipping company, our investigation as to this item would be at an end." Id. at p. 65,145.

Judge Harfeld's decision was directed to a case where the contention was that the price paid to the affiliated coal supplier was higher than the coal supplier's cost-of-service, and the price allowed in the utility's cost-of-service should be the actual cost reflected by the coal supplier's cost-of-service.

As noted earlier Judge Harfeld's Initial Decision in the above case was not acted on by the Commission since the parties entered into a settlement after the decision issued. However, the reasoning of that decision is important since Judge Harfeld affirmed his earlier decision when the same issue came up in the later case. *See* 13 FERC at p. 65,171. The later case, which is another PNM one, is reported at 13 FERC ¶ 63,041 and was ultimately affirmed by the Commission in Opinion No. 133.

Judge Harfeld's reasoning in his second Initial Decision is substantially the same as in the first decision. However, he found support for the earlier decision in the

Commission's "stand alone" theory of ratemaking which is stated to be that "neither regulated companies nor their affiliates should receive less revenue from their sales due solely to the mere affiliation between supplier and purchaser." 13 FERC at p. 65,169.

Judge Harfeld's discussion and reliance on market price evidence covered some matters presented in this hearing. One issue was whether the captive coal price was to be compared to a single weighted average price derived from other coal contracts or with a range of prices under other coal contracts. Even though the Staff supported a single weighted average price it did not say such a comparison alone would establish the unreasonableness of the captive coal price. 13 FERC at pp. 65,171, 65,173. Judge Harfeld decided that neither approach had been shown to be superior and therefore "a reasoned exercise of judgment and discretion must involve consideration of all proffered approaches." Id. at p. 65,174.

Judge Harfeld also decided that comparable market prices include those executed prior to the test year. 13 FERC at p. 65,173.

Whereas Judge Harfeld concentrated in his first decision on a situation where it was assumed the market price was higher than the cost-of-service, this is not mentioned in the second decision and at least in passing he addressed the situation where the cost-of-service is higher than the market price (13 FERC at pp. 65,170-71):

> Under a cost-of-service approach, the Company's coal expenses could be deemed to be cost-justified, yet higher than what they would be if PNM purchased its coal elsewhere. Clearly . . . public utilities are required to operate with all reasonable economies . . . . The [cost-of-service standard] would permit public utilities to engage in a course of action the

effect of which would be contrary to the best interests of the ratepayers. (Footnotes omitted.)

In Opinion No. 133, issued November 9, 1981, the Commission did more than just affirm Judge Harfeld's conclusion, it discussed at least some of the reasons for the affirmation (17 FERC at pp. 61,245-46):

> We affirm the judge's conclusion that the reasonableness of the cost of coal purchased from an affiliate should be determined by comparison to the prices of coal available from non-affiliated suppliers. *We believe that the interests of consumers will best be protected by permitting utilities that purchase coal from affiliates to recover no more from their rate-payers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier.*
>
> An attempt to test the reasonableness of coal costs by a cost-of-service analysis of an affiliated supplier would extend the scope of our rate-making analysis to an industry in which we have very little expertise . . . . Furthermore, fuel prices that may appear reasonable under a cost-of-service test may be higher than prices from non-affiliated suppliers . . . . *We believe that the best incentive for utilities to develop the least costly sources of fuel is to limit their fuel expense recovery from affiliated suppliers to amounts equal to prices available from non-affiliated suppliers in a competitive market.*
>
> We recognize the difficulties in identifying comparable prices . . . . The price comparison should . . . consider differences in the quality of the coal available from non-affiliated coal suppliers and that of the affiliate, such as sulphur, ash and moisture content, as well as Btu rating. Price differentials may also be justified with respect to the reliability of supply from the alternative suppliers compared to that of the affiliate, and to different market circumstances at the time long-term contract prices were negotiated. (Emphasis supplied.)

In a Commission order issued March 29, 1982, regarding a still later PNM rate filing, the Commission affirmed its holding in Opinion No. 133 respecting "captive coal" purchases not only for the reasons stated in Opinion No. 133 but also for the reasons stated by Judge Harfeld in his Initial Decision. 18 FERC ¶ 61,276. And in another PNM rate case treated in Opinion No. 164 (1983), the Commission again affirmed its decision in Opinion No. 133. 23 FERC ¶ 61,218 at p. 61,457.

In another PNM case Judge Gordon applied the market price test which the Commission approved in Opinion No. 133. 18 FERC ¶ 63,005 (1982). Of particular interest is the fact that Judge Gordon approved as reasonable a price paid for affiliated coal which was somewhat higher than the weighted average price of coal in a region used for purposes of comparison. Id. at pp. 65,023-24. The Commission affirmed Judge Gordon on this matter in Opinion No. 146, 20 FERC ¶ 61,290 (1982), for the reasons stated in the Initial Decision. Id. at p. 61,545.

2. Conclusions as to the Precedential Value of Opinion No. 133

Notwithstanding that the "captive coal" issue came up initially before Judge Harfeld in the context of the market price being greater than the coal supplier's cost-of-service, the reference in Judge Harfeld's second decision (13 FERC at pp. 65,170-71) and in the Commission's Opinion No. 133 about limiting the utility's pass through to ratepayers to a market price makes it clear the Commission envisions use of the market price test in instances where the market price is either above or below the coal supplier's cost-of-service.

Also it is clear that the Commission did not have in mind one set way of determining market price for all cases, or for the use of a single weighted average price as the sole reference point. Judge Harfeld concisely stated how market price evidence is to be employed: "a reasoned exercise of judgment and discretion must involve consideration of all proffered approaches." 13 FERC at p. 65,174. This reasoning, which the Commission later approved, plus the Commission's statements in Opinion No. 133 about the difficulty of determining the market price and the need to consider coal qualities, reliability of supply and different market circumstances at the time long-term prices were negotiated, lead to the conclusion that parties cannot be limited to any particular way to approach market price. The end result is to determine if the utility seeks to recover "more from their rate-payers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier." The word "comparable" connotes the need for judgment on many matters and fits in with Judge Harfeld's observation that an exercise of judgment and discretion is involved.

V. Staff's Market Evidence

The Staff relied upon two witnesses to make its presentation on the applicable market price. First, John Pyrdol, Industry Economist, Energy and Fuels Analysis Branch, Office of Electric Power Regulation, Federal Energy Regulatory Commission, developed a methodology by which to judge the reasonableness of affiliated fuel purchases (Exh. 13, page 3), and second, Dr. Eugene V. Kleber, Physical Scientist, Energy and Fuels Analysis Branch, Office of Electric Power Regulation, Federal Energy Regulatory Commission, applied Mr. Pyrdol's methodology to determine a market price for coal delivered to the Mitchell generating plant in order to evaluate the reasonableness of the price Ohio Power pays for the affiliated coal (Exh. 15, pages 10, 11).

A. Mr. Pyrdol's Methodology

Mr. Prydol undertook to explain why the price of affiliated coal from the Martinka mine should be compared to market prices as a test of reasonableness, and why such market-price test is valid from an economic perspective and is consistent with the purposes of utility regulation. Exh. 13, page 4.

The thrust of Mr. Pyrdol's testimony on the need for a market-price test is the difference between arm's-length open market transactions and inter-affiliate transactions; in the first case the utility has something to lose if it accepts a higher than market-competitive price, whereas in making purchases from an affiliated mine the utility's incentive to pay the lowest possible price may be blunted. Exh. 13, page 5. Hence, in the arm's-length transaction it may be assumed the utility has acted prudently, but a similar assumption cannot be made for inter-affiliate transactions. Id. In line with this thinking, Mr. Pyrdol would have different rules for deciding if a particular coal price should not go into the cost-of-service (*id.* at 6):

(1) Arm's-length transaction: Imprudence must be established in addition to a high price; and

(2) Inter-affiliated transaction: A simple showing that the inter-affiliate price is higher than the market price should automatically result in limiting the inter-affiliate price to market price.

From an economic theory standpoint, Mr. Pyrdol found the market-price concept to be sound. He testified that there is an "economic precept that the price prevailing in competitive markets represents the marginal costs of, in this instance, coal supply, under conditions of efficient management of resources. If goods and services are purchased by a utility at the marginal cost prevailing in a competitive market, then economic efficiency ordinarily would be maximized." Exh. 13, page 7.

Mr. Pyrdol found the market-price test to also be consistent with principles of utility regulation. He said there is a "long recognized principle that public utility regulation should seek to simulate competition and thereby enhance, to the extent possible, economic efficiency. [Since] [a]ffiliated coal companies are similar to public utilities, in that they are largely assured of a market for their goods, and are therefore isolated, to a significant degree, from incentives to operate efficiently that exist in competitive markets . . . it is beneficial, from a regulatory perspective, to judge the cost of an inter-affiliate or imprudently entered arm's-length coal supply agreement against competitive market prices for comparable coal." Exh. 13, page 8.

As for the method of determining a market price for a specific coal supply, Mr. Pyrdol said "there are many unique characteristics found in different regional and local coal markets serving different utility power plants; accordingly, the calculation of a market price must consider the particular circumstances of the coal market in question." Exh. 13, page 10. The market price is determined in three steps (*id.* at 11):

(1) Identification of the product market;

(2) Geographical boundaries of the market; and

(3) Selection of transactions to be examined within the product and geographic markets.

1. Product market

"A product market can be defined as a group of goods . . . each of which is readily interchangeable with the others. Since coals can vary widely in quality, the identification of the product market involves identifying acceptable ranges of coal quality characteristics to be included in the market analysis." Exh. 13, page 11. Since the effort here is to establish a market price for coal delivered to the Mitchell plant, the product market for

the Mitchell plant is defined by "looking for coals that can be used as substitutes for the coal presently being used to generate electricity at the Mitchell plant." *Id.* at 12.

2. Geographic market

"The purpose of defining the geographic boundaries to enclose a market is to identify that area within which actual or potential buyers realistically could turn to gain alternative supplies of the product, and within which the suppliers actually could supply the product." Exh. 13, page 12. With respect to the Mitchell plant the geographic market is that which "serves or could serve that plant." *Id.*

There is no hard and fast formula that can be applied to determine the boundaries of geographic markets, but several elements should be considered in determining the market boundaries of a particular generating station: first, the areas from which, in this case, Mitchell obtains coal from non-affiliates; second, areas from which other neighboring generating stations obtain comparable quality coal; and third, examine FOB mine price data and bid solicitations and responses. Exh. 13, pages 13, 14. Here, Mr. Pyrdol thought since there are a "a number of plants located relatively close to Mitchell, 50 miles or even 100 miles should define plants with a similar perspective on the market." *Id.* at 15.

3. Selection of transactions

Several factors must be considered in determining which transactions are to be included in the market-price analysis. "These factors include: transaction duration . . .; vintage of transaction . . .; and size of the transaction." Exh. 13, page 16. "Ideally, only arm's-length transactions that replicate, as closely as possible, the arm's-length contractual alternatives available at the time of the affiliated transaction should be used in the comparison." *Id.*

Economic literature suggests there can be a correlation between the duration of a transaction and prices; that is, "longer transactions appear to result in lower prices, everything else being equal." Exh. 13, page 17. "Since affiliated coal operations are set up to supply the parent utility with captive coal for the long term, or for the life of the mine, one must look at arm's-length transactions of a similar long-term nature for market-price comparison purposes." *Id.* at 18.

Economic theory suggests there is a correlation between the vintage of a contract and its present price; that is, "contracts of an older vintage, i.e., signed at an earlier date, may result in lower prices than newer vintaged contracts, everything else being equal." Exh. 13, pages 18, 19.

Economic theory indicates "there may be a 'volume discount' associated with larger volume contracts." Exh. 13, page 21. "The arm's-length contracts used to calculate a market price should be of a similar size or volume as the arm's-length contractual alternatives available when the captive coal contract was signed." *Id.*

There are two relevant prices available concerning coal sales: FOB mine price, *i.e.*, the price of coal at the mine and FOB power plant, i.e., the price of coal delivered to the plant. Exh. 13, page 22. Since it is "the price that a power plant should expect to pay for a substitute coal if it used that substitute coal rather than the affiliated coal supply" that is to be determined, the "FOB power plant prices should be used in the market price calculation." *Id.* With this in mind it is difficult to use FOB mine prices since adjustments must be made for transportation costs; furthermore, FOB mine prices are generally considered proprietary information in the coal industry and consequently there is a lack of data. *Id.* at 23.

The FOB power plant prices actually paid by other power plants located near the Mitchell plant as reported in Form No. 423 can be used. Exh. 13, page 23.

B. Dr. Kleber's Application of Mr. Pyrdol's Methodology

The annual requirements of the Mitchell generating plant are approximately three and a half million tons of coal. Exh. 15, page 12. A significant percentage of this coal is not affiliate coal but rather is provided by independent procedures. *Id.* The average annual price of independent coal delivered on contract to Mitchell was (*id.*):

	Cost per ton	*Cost per Btu*
In 1980:	$29.05	121.6¢
In 1981:	$32.63	137.9¢

The average annual price of Martinka coal supplied to Mitchell was (*id.* at 11, 12; Exh. 15HH, pages 1, 2):

In 1980:	$44.10	184.9¢
In 1981:	$63.59	268.7¢
In 1982:		206.8¢

The affiliated coal produced at the Martinka mine is a bituminous coal with an average heat content of approximately 11,800 Btu's per pound and an average sulfur content of approximately 1.5%. Exh. 15, page 11. The independent coal being burned at the Mitchell generating plant has somewhat different heat and sulfur contents than the affiliated coal from the Martinka mine. *Id.* at 13. The limitations of Mitchell's boilers require a minimum average Btu content of 11,500 Btu's per pound and a maximum sulfur content of 7.5 pounds of sulfur dioxide per million Btu's. *Id.* at 13. The independent coal being burned at Mitchell is, in Dr. Kleber's view, within the applicable physical and environmental limitations. *Id.* at 14.

Dr. Kleber examined coal purchases by neighboring generating plants in an attempt to identify independent

coal with quality characteristics generally similar to those of the affiliated coal produced at the Martinka mine. Exh. 15, page 14. He looked only at bituminous coal with a heat content greater than 10,000 Btu's per pound. *Id.* In addition, he looked at coal with a sulfur content ranging from 1% to 2% which roughly approximates the sulfur content of the Martinka coal and coal with a sulfur content ranging from 1% to 4% which roughly approximates the sulfur content of the independent coal which can be burned at Mitchell. *Id.*

He identified neighboring plants by examining those within 50 miles of Mitchell (13 coal-fired plants), within 75 miles (7 additional plants), and withir 100 miles (12 additional plants). Exh. 15, pages 14, 15. These plants all obtain coal from Bureau of Mines District Nos. 1-8, and this measure of the geographic market is generally corroborated by AEP's bid solicitation for coal for Mitchell. *Id.* at 15.

Drawing upon information provided monthly to the Department of Energy for individual generating plants in the response filed by electric utilities on Form No. 423, he identified coal with the necessary quality characteristic delivered under contract, excluding transactions of less than one year, to the identified neighboring generating plants. Exh. 15, page 16. In general this information showed (*id.* at 16-19):

Coal With 1-4% Sulfur

Plants Considered	*Year*	*Tons* *	*Number of Plants*	*Average Price* **	*Average Price* ** *without Bruce Mansfield*
Within 50 miles:	1980	14.7	13	119.5(123.2)	
	1981	15.6		134.2(138.4)	
	1982	11.6		149.6(154.2)	
	(9 mos)				
Within 75 miles:	1980	21.3	18	132.6	121.0(124.8)
	1981	21.4		153.3	135.4(139.6)
	1982	16.6		164.1	149.9(154.5)
	(9 mos)				
Within 100 miles:	1980	39.4	26	128.1	121.8(125.6)
	1981	34.4		147.2	135.9(140.1)
	1982	26.7		157.8	148.8(153.4)
	(9 mos)				

* in millions

** weighted average and delivered price in cents per million Btu's () shows adjustment because it has been found that nationwide coal prices reported on Form No. 423 were understated by 3.1%. Exh. 15, page 20.

Plants Considered	*Year*	*Tons* *	*Number of Plants*	*Average Price* **	*Average Price ** without Bruce Mansfield*
		Coal With 1-2% Sulfur			
Within 50 miles:	1980	2.0	8	136.8 (141.0)	
	1981	2.1		148.3 (152.9)	
	1982 (9 mos)	1.5		170.7 (176.0)	
Within 75 miles:	1980	3.9	12	132.8 (136.9)	
	1981	3.6		147.1 (151.7)	
	1982 (9 mos)	2.7		165.7 (170.8)	
Within 100 miles:	1980	13.7	18	121.1 (124.9)	
	1981	11.1		134.5 (138.7)	
	1982 (9 mos)	8.7		144.9 (149.4)	

* in millions

** weighted average and delivered price in cents per million Btu's () shows adjustment because it has been found that nationwide coal prices reported on Form No. 423 were understated by 3.1%. Exh. 15, page 20.

The tabulation of prices without the Bruce Mansfield generating plant being considered was supplied since coal shipments to that plant include high-priced affiliated coal that is currently being contested by the Commission Staff in *Ohio Edison Company*, Docket No. ER82-79-000. Exh. 15, page 18. Although there are 4 plants within 50 miles of Mitchell that received affiliated coal, the relatively small amount of that coal would only change the market price by less than one-half of one percent, and therefore they were not excluded. *Id.*

Comparing the cost of Martinka coal at the Mitchell plant to various average prices, the Martinka coal price exceeded the average prices as follows (Exh. 15, pages 21-22; Exh. 15GG):

Year:	*1980*	*1981*	*1982 (9 mos.)*
	(Dollars per Ton)		
Coal of 1-4% Sulfur - Within 50 miles	14.72	30.83	11.01
Coal of 1-2% Sulfur Within 50 miles:	10.47	27.40	5.86

Using coal with 1-4% sulfur delivered within 50 miles of the Mitchell plant the total overcharge, according to Staff, would be: 1980: $18.6 million; 1981: $28.5 million; and 1982: $22.2 million. Exh. 15, page 21; Tr. 994.

C. OPCO's Criticism of Staff's Market Evidence

1. Respecting Mr. Pyrdol's Methodology

Dr. John H. Landon, Vice President, National Economic Research Associates, said the "premise underlying Mr. Pyrdol's analysis is that it is appropriate to judge the efficiency of a utility's investment in fuel supply and its recoverability in rates by comparing its costs with subsequent market prices at a specific point in time." Exh. 9, pages 5, 6. He thought this treatment "inconsistent both with sound economics and with the manner in which utilities are regulated in other areas of their operations." *Id.* at 6.

Dr. Landon asserts that in "evaluating the prudence of an investment, the economically relevant comparison is between the *expected* value of the resulting stream of costs and benefits *over the life of the asset.* Such a comparison is, by definition, forward looking and should be made using the best forecasts of future market conditions available *at the time the investment is undertaken.*" Exh. 9, page 6. He is of the opinion that it "would be contrary to sound economic principles to discourage utilities from making long-term investments which have a positive present discounted value by establishing a policy of retroactively denying expenses which are in excess of alternative costs in a future short-run period." *Id.*

In Dr. Landon's view the relation between the cost of coal from Martinka and "market" price is an appropriate measure of the benefits to OPCO "if 'market' price is properly determined and the relationship of costs to market price is determined over the appropriate period." Exh. 9, pages 6, 7. "[T]he appropriate period for judging the prudence of a utility investment in mining is the life cycle of the mine as viewed at the time the decision to invest in the facility is made." *Id.* at 7. "A properly determined 'market' price would be based on projected delivered prices for equivalent coal (*e.g.*, sulfur content, ash content, BTU content, grindability, ash fusion temperature, etc.) allowing for differences in the security of supply, length of contract, variability of coal quality, and other contractual provisions which have significant economic value to the company." *Id.* at 7.

Dr. Landon thought the Martinka coal operation should be viewed within a wider context than was done by Mr. Pyrdol. He gave three reasons for this conclusion (Exh. 9, pages 7-9):

(1) "There is not a great deal of difference in the incentives motivating firms to be efficient between affiliate and independent mines if they all have cost plus rate of return or fixed price plus comprehensive escalation contracts. In any of these cases, it is long-run concern for the relations with customers which motivate efficiency rather than an immediate contractual relation between costs and profits."

(2) "It is not proper to view an individual coal supply arrangement outside of the context of all the other such arrangements made by the firm. . . . [I]t is entirely appropriate that utilities put together coal supply arrangements as a portfolio of contracts with differing durations and other terms and for coal from different sources. . . . Inherent in building such a portfolio, however, is the consequence that some types of arrangement with some sources will, ex post, appear more favorable than others at any given point in time."

(3) "Even a broader examination than a utility's coal contracts as a whole may be warranted. It is, after all, the cost of the power flowing from the generator that should be the focus of the utility's concern. . . . For example, paying a premium for fuel that allows a savings in construction costs and/or operating and maintenance expenses often will prove worthwhile."

Dr. Landon does not agree with what he says is a major premise of Mr. Pyrdol, that market price is an appropriate benchmark against which to measure affiliate transactions because it is equal to marginal costs which represent the real resource costs of efficiently operated firms. Exh. 9, page 10. In brief, he thinks this premise is only correct if the market is in long-term equilibrium in which case market price will be equal to the long-run marginal costs of production, and the coal market has not been in a state of long-term equilibrium; consequently, observed prices are not equal to marginal costs. *Id.* at 10-13. Dr. Landon asserts this analysis is important since without "a theory supporting the use of

. . . 'market price' as an appropriate benchmark, there is no basis for using the difference between it and the affiliate coal price as a measure of excessive cost which can be disallowed in setting rates." *Id.* at 13.

Another problem which Dr. Landon stated arises from judging a utility's decision to produce rather than buy from others by comparing current production costs with current market prices is that such a standard "would limit the revenue of utilities to some average 'market' level [and] would increase their business risks and cost of capital." Exh. 9, pages 14, 15.

2. Respecting Market Price Determination

According to Dr. Landon, the "cost of coal supplied to other generating plants in the same geographic area is not a good proxy for what Ohio Power Company would have paid independent vendors for coal deliverable to its Mitchell generating plant" because: (1) "Individual plant characteristics vary over a substantial range and dictate, to a large extent, the relationship between the physical characteristics of coal and the economics of plant operation;" (2) the data available to Staff did not allow for quantification for factors such "as contract vintage, contract duration, delivery schedules and other terms and conditions;" (3) the 50, 75 and 100 mile radius measures used to establish geographic market areas have no particular basis in economics; and (4) the use of delivered coal prices creates an obvious source of error. Exh. 9, pages 16, 17.

Furthermore, the Staff evidence is flawed since it compares "the price of a *specific* transaction between affiliated companies with an *average* of prices of transactions between unaffiliated parties."[1] Exh. 9, page 19.

[1] Mr. Pyrdol, from an economist's point of view, agrees with the use of a range of prices for a comparison, but believes the Commission's Opinion Nos. 133 and 164 specify use of the average price. Tr. 961-62. OPCO believes Opinion No. 133 affirmed a comparison by use of a range of prices. OPCO Initial Brief, pages 170-71.

Mr. Gerald Blackmore, Executive Vice President for Fuel Supply for the American Electric Power Service Corporation, said the "only valid 'market price' comparison in the context used by the Staff would be comparison of 'like' coal from similar mines with similar economic parameters"—the "ultimate test of any 'like' coal would [be whether it would] yield a similar performance in the steam generator." Exh. 4, page 26. Furthermore, he testified "one would need to consider the value to the buyer of the duration and conditions under which such 'like' coal might be obtained." *Id.* at 26, 27.

Mr. Blackmore thought a possible approach is a "marginal" price comparison which should be made where the "marginal mine-mouth price is assumed to equal the cost of coal produced from the last mine opened (marginal mine)." Exh. 4, page 35.

D. Discussion and Conclusions Respecting Staff's Market Evidence

1. Methodology

Any methodology relevant to the question of whether the utility seeks to recover "more from their rate-payers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier" is acceptable. That is the ultimate question the Commission indicated in Opinion No. 133 is to be answered. The methodology described by Mr. Pyrdol would reach a relevant result. However, as discussed hereafter, that methodology was not applied by the Staff in an acceptable manner and the end result of the Staff's implementation has little relevance.

Dr. Landon takes issue with the Staff's use of a market-price approach. In light of the adoption of that approach

by the Commission in Opinion No. 133 the Staff correctly reasoned that a market-price comparison was to be used. What the Commission did not specify is what sort of market price is to be used. For example, the Commission approved consideration of a range of market prices, but it did not rule out consideration of a single weighted average. The Commission made several statements in Opinion No. 133 that support the conclusion that any market price relevant to the question quoted above can be considered. For example, it said that "the reasonableness of the cost of coal purchased from an affiliate should be determined by comparison to the prices of coal available from non-affiliated suppliers"; "[p]rice differentials may also be justified with respect to . . . different market circumstances at the time long-term contract prices were regulated"; and it recognized "the difficulties in identifying comparable prices." 17 FERC at pp. 61,245-46.

These statements are interpreted to mean that even though the end result sought is what price would have been incurred "if a comparable coal supply contract had been made with a non-affiliated supplier" at the time the commitment was made to the affiliated supplier, any type market price that might assist in answering that question can be relied upon. Specifically in this case it is relevant to consider market prices for someone entering the market on a current basis; it is relevant to consider market prices for someone buying from a newly opened mine; and it is relevant to consider current, past, and future market prices under other contracts entered into at the time OPCO committed itself to the Martinka coal. Of course the weight to be given this evidence is the difficult problem, and, as Judge Harfeld said, the full range of relevant evidence must be subject to "a reasoned exercise of judgment and discretion."

When this flexibility is built into the market price approach some of Dr. Landon's objections are answered. In particular his view that the commitment to affiliated

coal must be looked at over the full range of time that commitment is made for is covered by looking at market prices for comparable contracts entered at the same time as the affiliated coal commitment over the full range of time the contracts run. Obviously in deciding if OPCO made a good deal in this case it would be relevant to know how their prices will compare over the full life of their arrangement when compared with an arrangement made by others with non-affiliated suppliers. This doesn't mean that this type evidence must be introduced; only that if it is introduced it would be relevant.

Even though the evidence introduced in this case does not permit of an analysis of how good an arrangement OPCO has for the Martinka coal from the present into the future, that sort of analysis would also be relevant. The fact that a commitment to affiliated coal looked reasonable at the time it was entered into, and was as good an arrangement as was available at that time from non-affiliated coal-suppliers, does not mean that it would be prudent for an affiliated coal supplier arrangement to be continued. If changing conditions would indicate that projected market prices show that continuation of an affiliated coal supplier commitment was not prudent, a discontinuation of the affiliated arrangement might be required.

Mr. Pyrdol agrees with OPCO that the test of whether costs should be allowed in the cost-of-service can't be justified solely by looking at a single point in time. Exh. 13G, page 2. He overcomes that criticism by saying the market standard is to be applied in a continuing fashion into the future. Id. at 3. However, Mr. Pyrdol is not certain as to how the situation would be handled, in Staff's view, when the price of coal from Martinka becomes cheaper than the market price; *i.e.*, will OPCO be allowed to recover from its ratepayers the difference between Martinka coal prices and market prices, just as it would be required to forego recovery of such differ-

ences when Martinka coal is priced higher than the pertinent market price. Id. at 3, 4. Mr. Pyrdol says he has not been presented with such a case but the "starting point for [his] review . . . would probably be that it would be reasonable to charge a market price for affiliate coal, although there may of course be some exceptions." Id. at 4. In any event OPCO's concern that it might be whipsawed between the Commission only allowing it "market price" and the Securities and Exchange Commission only allowing OPCO to pay the actual cost-of-service, with the end result that the rule would be for OPCO to not be able to recover its in-excess-of market costs when that situation occurred, and on the other hand not being able to gain any benefits if the Martinka mine costs should be less than "market price" is real. *See* OPCO Reply Brief, pages 8, 9, 37.

From a theoretical standpoint Mr. Pyrdol's notion of a continuing windfall or penalty as the market conditions change sounds fair. However, such an approach would only be reasonable if regulated entities should be penalized for decisions that turn out bad even though on the basis of the facts as they appeared at the time the decision was made the decision-makers acted reasonably. Such an approach would not be consistent with the overall approach to regulation.

2. Market price

To determine if there are advantages or disadvantages to purchasing the Martinka coal on a short-term basis is an integral part of deciding if there are overall advantages from either the long- or short-term point of view. The record doesn't provide any clue as to what the long-term consequences are of OPCO purchasing coal from the Martinka mine. There is considerable evidence about the short-term situation.

Staff takes the position that the coal contracts considered by Dr. Kleber, even though identified by only the

Btu and sulfur levels and consequently not necessarily capable of being burned at the Mitchell plant without causing problems like those experienced from the McElroy coal, still give a pertinent market price for comparison purposes. Staff argues that the market price for coal used within the pertinent geographic area is determined by Btu and sulfur levels and hence it isn't necessary to know if the coal has other qualities such as would be needed for burning in the Mitchell plant. For example, even if only coal with an ash fusion temperature of about 2700 degrees should be burned in the Mitchell plant, Staff contends the price of such coal would be controlled by what its Btu and sulfur levels are, rather than because it has a particular ash fusion temperature. OPCO says that coal prices are determined by many factors and consideration of market prices by only segregating transactions by Btu and sulfur levels is meaningless.

As discussed hereafter, OPCO is correct. The Staff has not persuasively established a market price for coal under circa 1970 contracts that could be substituted for Martinka coal at the Mitchell plant, and the evidence is persuasive that it makes economic sense for OPCO to use a coal of the quality of that from the Martinka mine even if it is more expensive than the coal used in the past. The Staff failed by not looking beyond the Btu and sulfur levels of the contracts it used, and by not examining in more detail the impact of the years the contracts were entered into, *i.e.*, the contract vintage.

a. Suitable coal for use in the Mitchell plant

Staff argues that in "determining whether Martinka coal is comparable to the coal used in Staff's study, the coal the Mitchell plant was designed to burn should be used, not the coal OPCO uses currently." Staff Reply Brief, page 75. This position is rejected. When, as discussed hereafter, the coal used in the Mitchell plant in the past, which was a coal the Mitchell plant was designed to burn (Exh. 4, pages 15-16), has caused ex-

cessive downtime in the plant, it is meaningless to compare the cost of such coal with what the plant requires to operate economically. There is nothing persuasive in the record to indicate the Mitchell plant can accomplish the same operating results as it is achieving by use of the Martinka coal with a coal of different quality. The Staff's witness Charles McCann, a chemical engineer at the Pittsburgh Energy Technology Center, Department of Energy, testified that he had "no notion of what [coal the Mitchell plant] is currently capable of [operating on]." Tr. 1278. Mr. McCann agreed with the logical statement that "to make an informed judgment of what coal should be burned at the Mitchell plant, one must be familiar with actual operating experience at Mitchell based on different coals used and also [with] a complete evaluation of the boiler's actual operating conditions." Tr. 1323. This is the background OPCO had before deciding to burn the Martinka coal.

The Hall studies done by OPCO in 1976 and 1977 (Exh. 32B, part III, pages 5, 6, 11-14, Appendix D; Exh. 32C, parts V, VI; Exh. 32E, page 3) and the actions of OPCO in relation to Mitchell Unit No. 2 subsequent to that repor are consistent with credible OPCO witnesses stating that coal of an ash fusion temperature of 2700 degrees should be burned in Mitchell Unit No. 2 if the excessive downtime that Unit experienced in past years is to be avoided (Exh. 2, pages 5-7; Exh. 3, pages 40-45; Exh. 4, pages 16-18, 25). For example, in 1980 and 1981 OPCO solicited bids for coal to be used in the Mitchell plant and one of the specifications was an ash fusion temperature of 2700 degrees. Exh. 15DD, 15LL. The ash fusion temperature of the McElroy coal which OPCO believes caused the excessive downtime of Mitchell Unit No. 2 is about 2190 degrees. Exh. 3, page 22.

Furthermore the evidence that the economic consequences of keeping Mitchell Unit No. 2 operating more often than it has in the past justifies paying about $12-18 per ton more for a more suitable coal compared to the McElroy coal is unchallenged. Exh. 3, page 46; *also see* Exh. 4, pages 23-24; Exh. 32E and Exh. 7 thereto; Exh. 32B, part IV; Exh. 32D and Exh. V.b.-15 thereto; and Tr. 577-78, 590-91. Staff and OPCO both agree that the ash fusion temperature of coal bears significantly on unit availability.[2] Staff Initial Brief, page 36. Since the $12-18 per ton would essentially offset any difference the Staff found to exist between the price paid for Martinka coal and Staff's market price, the switch to that quality coal was justified. This still leaves the question as to whether OPCO could have achieved this economic benefit by buying coal of a quality comparable to Martinka coal at a cheaper price.

The Staff evidence by Mr. Schuppin that the AEP system does not need the capacity it gets at Mitchell by improved availability (Exh. 16, page 4) was rebutted by OPCO. Mr. Schuppin in essence says OPCO should keep burning the McElroy quality coal at Mitchell since it can get it cheaper and the fact that Mitchell has excessive downtime isn't important since AEP has more capacity than it needs anyhow. Mr. Schuppin agreed during cross-examination that utilities are able to sell excess electricity, at least sometimes, when they have excess capacity. Hence, it is not possible to conclude that OPCO is merely increasing the Mitchell plant availability so that it can shut in that plant part of the time, or so some other plant on the AEP system can be shut in. The fact that AEP sells 35% of its electricity to other utilities also undermines Mr. Schuppin's thesis (Tr. 567-68), particularly since the "cost of generating power on the AEP system is

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[2] Staff's Reply Brief, pages 81-82, seems to take a different view. In part this is based upon comparing the operation of Mitchell Units 1 and 2. The Staff comparison is not persuasive since Unit 1 has been de-rated to 660 MW and operation at this lower level permits different quality coals to be burned. Exh. 3, page 42; Exh. 3A, pages 6, 7.

considerably lower than [for] some of the surrounding neighbors." Tr. 764.

David H. Williams, Jr., Senior Vice President-Operations, AEPSC, disagreed with Mr. Schuppin's conclusions (Exh. 2G, pages 1, 2):

> [O]ur objective is to generate power at the lowest possible cost on a reliable and continuous basis. Our decisions regarding coal quality at the Mitchell Plant, as well as the other fossil plants on the AEP system, must be based on maintaining reliable operation on a continuous basis. It is one thing for management to decide to shut down capacity that may not be required at a particular time. It is quite another thing for the capacity to be forced out of service due to poor quality coal.... We think it is in our customers' best interests to supply coal that meets the designated unit specifications.

Mr. Williams' statement makes sense.

b. New contract prices versus pre-existing market prices

In analyzing the evidence it is important to make a distinction between "new contract" market prices and "pre-existing contract" market prices. An important distinction is that a purchaser entering the market on a current basis is likely to pay a different price for the same coal that is being bought by others under preexisting contracts. The Staff does not seem to argue that OPCO's purchase of Martinka coal should be judged by what "new contract" purchasers would pay for comparable coal. Tr. 925-27. Rather, Staff seems to assert OPCO should be judged by what is actually being paid for comparable coal by puchasers who entered into applicable purchase agreements at the time OPCO committed itself to using Martinka coal. Id. This approach was expanded by Staff to pertinent contracts at least one year in length on the basis of its conclusion that neither the vintage nor duration of

the contracts significantly influence the prices paid under "pre-existing" contracts in 1980-1982.

In any event it is relevant to know what OPCO would have to pay to buy comparable coal under a new contract. The record includes several documents respecting two bid solicitations for coal to be burned at the Mitchell plant conducted by AEPSC on behalf of OPCO. These documents indicate:

(a) January 16, 1980 socilitation (Exh. 15DD): The specifications for the coal in part were:

	Minimum	*Maximum*	*Normal*
Btu's/Lb.:	11,800		12,000-12,500
Ash Fushion Temperature, Softening Hemispherical in Reducing Atmosphere:	2700°		
Sulfur Content:		1.5%	.8-1.5%

Sixty coal offers were received in response to the solicitation (Exh. 15DD, Schedule 4) but only twenty-two offers met Mitchell specifications (*id.* at Schedule 5). Meetings were later held with three suppliers "meeting plant coal specifications as well as the bid letter requirements" and it was recommended that 50,000 tons/month be purchased at a base price of $29/ton (an additional transportation charge of $4.45/ton was involved), 12,500 Btu's subject to a quality adjustment of $0.35 per 100 Btu's; the specifications in part were: Ash 12% Maximum; Sulfur 1.5% Maximum; Btu 12,500 Minimum; Ash Fusion Temperature, Softening Hemispherical in a Reducing Atmosphere 2800° Minimum.

(b) June 18, 1981, solicitation (Exh. 15LL): The specifications for the coal were similar to those in the January 16, 1980, solicitation *supra*. Part of the papers preceding the solicitation is one titled "Specifications per Plant Engineering" and it shows various specifications for the Mitchell and two other plants. Mitchell's specifications include items not included in the solicitation letter but to

the extent that specifications are shown in the bid letter they are substantially consistent with the Mitchell "Specifications per Plant Engineering." Twenty coals were offered which met the specifications provided in the bid letter. The delivered prices at the Mitchell plant ranged from 139.65¢/MMBtu-210.28¢/MMBtu, or approximately $33-$50/ton.[3]

The 1980 offer of $33.45/ton delivered (the next to lowest offer received) is to be compared with the price of $44.10 per ton paid by OPCO for Martinka coal in 1980; the comparison is not accurate to the extent that the Martinka coal is a circa 11,800 Btu/pound coal whereas the 1980 bid coal was based on 12,500 Btu/pound. In 1981, the solicitation produced offers of delivered prices at the Mitchell plant from 139.65¢/MMBtu-210.28¢/MMBtu. These are to be compared with the price of 268.7¢ paid by OPCO for Martinka coal in 1981. As a matter of perspective, there were particular operating problems at the Martinka mine in 1981 and also its unit costs were affected by a strike during March-June; in 1982 the average price paid for Martinka coal was 206.8¢. Tr. 69-71; Exh. 15V; Exh. 4, page 20; Exh. 5, pages 15-18.

Even though the 1980 and 1981 bid solicitations lead to the conclusion that Martinka quality coal could have been obtained at a cheaper price than was paid by OPCO for the Martinka coal, this conclusion is tempered by the fact that the 1980 contract offer was for a minimum of 3 years and the bid may have been made at a time when the coal market was soft (Tr. 644). The 1981 solicitation was for contracts from 1 to 15 years in length, and the market again may have been soft. Exh. 8, page 8.

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[3] The price per ton is computed by the formula in Exh. 15A and assuming coal with 11,800 Btu which is about what the Martinka coal was in 1980-82. Exh. 15P, Schedules 1, 2 at pages 12, 13 respectively; Exh. 15KK, page 12.

If the Staff's argument that neither vintage, duration, or quantity of a coal contract affects the price is accepted, it would be expected that the prices offered in 1980 and 1981 would approximate the averages Dr. Kleber arrived at in his analysis. This expectation would only hold true if comparable coals, in a price sense, are being considered. The average of the 22 offers made in 1980 was $1.6/MMBtu and of the 20 offers made in 1981 the average was $1.8/MMBtu.[4] Assuming for gross comparison purposes only that the coals were 12,500 Btu, these averages convert to $40 and $45/ton. *See* Exh. 15A for the formula used. Dr. Kleber's weighted averages for 1-4% coal in 1980 and 1981 were $1.2 and $1.4/MMBtu for plants within 50 miles of Mitchell. This comparison raises doubts as to Dr. Kleber's conclusion that his average prices are for coal comparable, in a price sense, to Martinka. Dr. Kleber's averages for 1-2% sulfur coal were $1.4 and $1.5/MMBtu for 1980 and 1981 for plants within 50 miles of Mitchell but the difference from the bid averages are still enough to cause one to question the assumptions made by Dr. Kleber; and *a fortiori* when the soft coal markets of 1980, 1981 are considered. On the other hand the offered prices are just that and might have been lower if further negotiations had been carried out.

Another interesting comparison is of the 1980, 1981 bid averages with what OPCO paid for Martinka coal in those years: about $40 for the bid average in 1980 compared to a Martinka price of $44.10 and about $45 for the bid average in 1981 compared to a Martinka price of about $48 in 1982—the 1981 Martinka price is disregarded because of the unusual factors involved in that year.

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[4] The information on the bids is found on Exh. 15DD and 15LL. The averages are not weighted averages, but rather are averages of price numbers found in the exhibits rounded off to the nearest tenth, that is, for example, 139.65¢/MMBtu was rounded to $1.4.

OPCO witness Gerald Blackmore, Executive Vice President for Fuel Supply, AEPSC, suggested that the price of coal from the Martinka mine should be compared to the marginal mine-mouth price, that is the cost of coal produced from the last mine opened. Exh. 4, page 35. The comparison which Mr. Blackmore said would do this showed prices quite similar to the current Martinka price. Id. at 36, 37. Mr. Pyrdol criticized this suggestion as being one that "would require ratepayers to perpetually pay the price of investing in a new coal mine and to perpetually enter the market anew." Exh. 13G, page 12. Mr. Pyrdol said the Staff's comparison is preferable—it focuses "on independent, arm's length coal contracts being signed at the time of the captive contract and then [looks] at the present day prices of these contracts to establish a market price for the captive coal." Id. at 13. According to Mr. Pyrdol this tells "what Ohio Power would likely be paying today if it had chosen an independent, arm's length contract(s), rather than the captive mine." Id. at 13.

c. Coal purchase transactions suitable for market analysis

Mr. Pyrdol and Dr. Landon agree on a fundamental criterion for market prices. They have to be prices for coal "that can be used as substitutes for the coal presently being used to generate electricity at the Mitchell plant." Exh. 13, page 12; Exh. 9, page 7. Even though Dr. Kleber sponsored some evidence designed to infer the Mitchell Unit No. 2 could efficiently burn coal with different qualities than are found in the Martinka coal, the preponderance of the evidence, as discussed in a., above, is to the contrary.[5]

[5] Dr. Kleber testified that flexibility in the type of coals that can be burned at Mitchell is evidenced by the fact that past purchase orders have specified ash fusion temperatures of 2500° and 2600° compared to current specifications of 2700°; two purchase orders specify a Hardgrove Grindability Index at 80-90 when the Mitchell plant specification is an upper-limit of 80; whereas the boiler specifications for Mitchell call for a maximum ash content of 15% and a maximum sodium oxide content of .75%, a washed sample of Martinka coal in April 1981, exceeded these numbers, and the average monthly ash content of Martinka coal exceeded 16% for a number of months in 1980-82. Exh. 15HH, pages 5-7.

(1) Btu and sulfur levels as price determinants

The Staff's basic position is that even if coal at Mitchell should be comparable to the Martinka coal in a physical sense, the only important price determinants are the Btu and sulfur contents. Exh. 15RR, pages 8, 9; Exh. 13J, pages 2-3. To substantiate this conclusion Dr. Kleber recalculated market prices for coals used in plants with dry bottom boilers and for coals with high volatility and found the market prices differed only slightly from the market prices for all plants within 50 miles of Mitchell. Exh. 15RR at 9.

Dr. Kleber noted that the Mitchell generating plant consists of two units, each with a dry bottom boiler. Exh. 15HH, page 3. Because of that he examined the neighboring plants he used to see which had dry bottom boilers and found that if his market-price analysis for the first 9 months of 1982 had been limited to those plants with respect to coal with 1-2% sulfur and 1-4% sulfur there was very little difference from his initial calculations. Id. at 3, 4; Exh. 15QQ, pages 5, 6.

To give weight to Dr. Kleber's calculations it must be assumed that *all* dry bottom boilers of neighboring generating plants were burning Martinka quality coal. There is some basis for this assumption in that Mr. Doherty on behalf of OPCO identified the basic problem with the McElroy coal at Mitchell was that it was suitable for wet bottom boilers. Mr. Doherty said that wet bottom and dry bottom boilers require coal with different ash fusion temperatures. Exh. 3, page 9. However, there is too much uncertainty as to whether the situations at the neighbor-

ing plants are such that they have been using Martinka quality coal. It could be that at least some of the plants are using McElroy quality coal and having problems similar to those that Mitchell has had, or that for some reason their dry bottom boilers don't require coal with the same ash fusion temperatures as Mitchell requires. *See* Exh. 3, page 7. Mr. Doherty said he was unable to correlate coals used at other plants with the needs of the Mitchell plant since he did "not know the detail design and operating experience that those units have experienced." Exh. 3A, page 8. The obvious way to resolve uncertainties would be to find out what the exact specifications of the coal were that was burned in these other dry bottom boilers. Staff did not do this. Tr. 1022, 1058-59, 1142-43. Absent confirmation of a connection between what the neighboring plants were paying for coal with what was paid for Martinka coal, Dr. Kleber's study is not persuasive of the conclusion he reaches.

There is an inconsistency between the positions taken by Staff witnesses Pyrdol and Kleber. Mr. Pyrdol was of the opinion that a lengthy list of factors (Exh. 9C) could influence the price a buyer would be willing to pay for coal. Tr. 799-801. If this is true, and other witnesses also thought factors other than Btu and sulfur could influence the prices paid (Exh. 4, pages 26, 27; Exh. 8, pages 4, 9-10; Tr. 620-21, 629, 649-53; Exh. 9, page 7), it is not possible to say that contracts used as showing comparable prices for Martinka coal should not be examined to see if some of these other factors did not cause a significant change in the price. The empirical evidence supporting Dr. Landon's conclusion that these other factors can be significant is the way the prices of coal with about the same Btu and sulfur varied in the 19 contracts Mr. Pyrdol looked at in his study of the effects of vintage. For example in 1973 the two contracts plotted by Mr. Pyrdol were about 112¢/MMBtu and 148¢/MMBtu, and a even greater spread occurred in 1980 (102-175). Exh. 13H,

page 1. The immediate question posed is why there should be such a spread in price for coals of similar Btu and sulfur content if those are the only significant price determinants. When Dr. Landon plotted a larger number of contracts with comparable Btu and sulfur contents for coal delivered within 50, 75 and 100 miles of the Mitchell plant the variations on a month-by-month basis are generally large—a 30% or so variation being quite common.[6] Exh. 9M.

Staff's conclusion is rejected. Something more than a mere segregation of contracts by Btu and sulfur content is required to arrive at an average market price for coal of the quality of that from the Martinka mine based on long-term contracts. Therefore, there is no credible long-term market price for the Martinka quality coal in the record.

(2) Vintage, duration and quantity aspects of selected contracts

Notwithstanding that Mr. Pyrdol thinks contracts of the same vintage as the acquisition of the Marinka mine by Ohio Power should be considered, he recognized that there might not be enough vintage contracts available to

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[6] Dr. Landon plotted the monthly prices for transactions within Dr. Kleber's 50, 75, and 100 mile areas and found wide variations within the months for the years 1980 through 1982. Exh. 9H, pages 16-17. He thought there were a number of reasons for the diversity (*id.* at 17-19): (1) differences in coal qualities other than Btu and sulfur, (2) differences among plant locations, (3) differences in the vintage of contracts, duration of contracts, and quantities of coal obligated, and (4) differences in specific contract conditions.

Dr. Kleber responded to Dr. Landon's studies. Exh. 15RR. He compared the monthly and annual average price for Martinka coal with the monthly price entries Dr. Landon plotted and found that the Martinka price was the highest priced coal in the market region in 29 out of the 36 months plotted, and either the second or third highest price in 5 out of the other 7 months. Id. at 1. Dr. Kleber also stated that the fact that Dr. Landon plotted unweighted prices detracted from the meaningfulness of the study. Id. at 1.

make a meaningful analysis and, therefore, contracts of different vintage may have to be used "with attention given to the possible effects different vintages may have on the market price calculation." Exh. 13G, page 13. In fact, of the contracts included in Dr. Kleber's study, over 75% are contracts entered or renegotiated into after the time of the initial development of the Martinka mine. Exh. 15, page 15.

The Staff made an analysis of "the relationship between contract vintages and prices for plants included in Staff witness Kleber's market price calculation." Exh. 13G, page 14. By vintage Mr. Pyrdol meant the time period in which a contract was signed or a definite commitment was made to a relationship. Tr. 797. Based on that analysis Mr. Pyrdol concluded "that using contracts of different vintages does not have any consistent, discernible effect on the market price calculation for coal coming from the Martinka mine." Exh. 13G, page 15. A similar analysis showed that there is "no meaningful relationship between either the length of the contract or its size, and current prices." Id. at 15. Mr. Pyrdol used contracts for coal with 1-2% sulfur delivered to plants used in Dr. Kleber's market price analysis; the data respecting those contracts came from an investigation of electric utility fuel purchasing practices, Docket No. IN79-6. Id. at 15. He based his conclusions on various graphs (Exh. 13H) and to substantiate his conclusions the Staff requested the Energy Information Administration (EIA) to statistically analyze the data. Id. at 16. EIA concluded there was no significant relationship between coal price and vintage, size, or duration. Id. at 16.

Dr. Landon took issue with Mr. Pyrdol's conclusions. In essence he says the wide fluctuation in prices in contracts signed in any particular year makes it impossible to conclude whether or not the year a contract is signed influenced the price agreed upon. Exh. 9D, pages 2, 3; Exh. 9H, page 2. In other words, where the 1981 price

paid for coal contracted for in 1974 ranges from about 129§/MMBtu to 172§/MMBtu, it isn't logical to reach any conclusion as to how important the fact is that the contracts were negotiated in 1974. This reasoning is persuasive. It may well be that the fact the contract was negotiated in 1974 was very important, but before this could be ascertained some explanation would have to be found for why there is such a wide variation in the prices for contracts negotiated in the same year. Looking at the graphs for contract size and contract duration plotted against price (Exh. 13H) similar variations occur which make it illogical to assume that the plots show any relationship between price and these factors. But again, the plots don't prove there is no relationship.

In brief the graphs are consistent with the conclusions Mr. Pyrdol makes about no relationship being shown between these various factors and price, but they do not support a conclusion that no relationship in fact exists. Whether there is such a relationship would require a more extensive analysis than was done by Mr. Pyrdol.

Dr. Landon had other criticisms of Mr. Pyrdol's analysis respecting vintage, size and duration of contracts in relation to the 1981 coal prices under those contracts. In summary the criticisms were (Exh. 9H, pages 4-6):

(a) The majority of the contract summaries relied upon by Mr. Pyrdol in making his analysis did not report the average price paid for coal delivered to the designated plants; instead, they give a range of prices and Mr. Pyrdol simply averaged the high and low prices paid for use in his analysis.

(b) Sulfur and Btu content were frequently given only in broad ranges, and in such instances Mr. Pyrdol simply averaged the high and low values.

(c) The data used in Mr. Pyrdol's analysis is not representative of the contracts underlying the transaction prices averaged by Dr. Kleber. Mr. Pyrdol used 19 con-

tracts whereas Dr. Kleber relied upon more than 100 contracts.

(d) Various errors in taking the data from the data base.

Using the same basic data, but corrected as he thinks it should be, Dr. Landon analyzed the data and concluded that with the changes he made there was a complete reversal of the conclusions which had been reached by Mr. Pyrdol. Namely, "[i]nstead of finding no significant relationship between transaction price and the date, duration and size of contracts . . . [Dr. Landon concluded] all these factors [do] have a statistically significant relation to the delivered prices." Exh. 9H, page 8. Dr. Landon also made a study based on a larger number of contracts and found there are relationships between price and vintage, price and contract duration, and price and contract size. His study is discussed in subsection (3), *infra*.

In response to Dr. Landon's criticisms, Mr. Pyrdol testified as to why the use of the average of prices for Btu and sulfur did not impair his conclusions (Exh. 13J, pages 5-6) and why his data base was appropriate (Exh. 13J, pages 4, 7-11). Mr. Pyrdol accepted some of Dr. Landon's criticisms and ran another regression analysis which he said did not alter his conclusions. Exh. 13J, page 11.

Respecting Dr. Landon's regression analysis of the 19 contracts data base relied upon by Mr. Pyrdol, which Dr. Landon asserts shows a significant relation between delivered prices and vintage, duration and contract size, Mr. Pyrdol said these conclusions were only reached after Dr. Landon eliminated four of the nineteen contracts. Exh. 13J, page 11; Tr. 1459. Mr. Pyrdol did not think two of these contracts should have been eliminated. Exh. 13J, page 12.

Dr. Landon explained why he excluded the four contracts (Tr. 1500) but even if the exclusions are considered proper, when the graph for vintage and price prepared by Mr. Pyrdol (Exh. 13H) is examined with those four contracts eliminated, the variations in price are enough to make one doubtful of any conclusions drawn from such data. Furthermore, the total number of plots on the graphs would be reduced from 19 to 15 and this seems like a very small number for drawing any conclusions. Also Dr. Landon used the average numbers which he criticizes Mr. Pyrdol for using. Tr. 1501. Finally, Mr. Pyrdol's testimony that certain of the plots should not have been removed is sensible. Consequently, the study made by Dr. Landon of Mr. Pyrdol's 19 contracts is no more persuasive of any definite conclusions than is Mr. Pyrdol's study.

There is persuasive evidence in the record that it can be very important to examine the particular year a contract is negotiated. Mr. William Renton, an independent marketing and sales consultant to the coal industry, who has participated in the coal marketplace for many years gave detailed testimony as to how the years of a soft or tight (demand exceeds supply) coal market effect the prices negotiated for coal. Exh. 8, pages 5-8; Tr. 630-32, 639-48, 651-52. These are not assertions made on the basis of some sort of statistical analysis. These are assertions made on the basis of having been a participant in the coal marketplace over a span of years. Mr. Renton's testimony is persuasive that it is a mistake to try to arrive at what the average market price was for coal purchased at about the time the Martinka contract was entered into without looking carefully at the vintage of the putative comparable contracts relied upon and the state of the market at the time the putative comparable contracts were negotiated.

The large fluctuations in coal production during the period 1967-1981 (Exh. 9A) are consistent with this conclusion; it would be expected that during the years where production fell that a reduction in demand was the cause and that at such times a surplus of coal was

available and the sale prices would be less. Mr. Pyrdol observed that older contracts negotiated during tight coal markets may lead to higher prices than more recent contracts negotiated during soft coal markets. Exh. 13, pages 19, 20.

(3) Dr. Landon's analysis of contracts

Dr. Landon testified that he did an analysis of as complete a set of contract information as possible for the thirty-one plants in Dr. Kleber's analysis. Exh. 9H, page 9. In addition to the information used by Dr. Kleber, data were collected on "moisture content, ash content, mine type (surface or deep), mode of transportation, transportation distance and contract specifications for sulfur, ash, moisture and Btu content as well as the delivered specifications used by Mr. Pyrdol." Id. Data were not available as to ash fusion temperature. Id. at 21. The contracts selected were those identified by Dr. Kleber plus those for the three additional plants Dr. Landon had recommended be added to the market. Id. at 9. Eliminated from the data base were those contracts "which did not meet the sulfur and/or Btu criteria used by Dr. Kleber in his transactions analysis." Id. at 10.

Instead of analyzing 19 contracts for 12 plants as used by Mr. Pyrdol, he said he used data from over 200 contracts covering deliveries to 26 of the 31 plants in Dr. Kleber's analysis. Exh. 9H, page 10. Furthermore, data were collected for the years 1979, 1980, and 1981, instead of for only 1981, a strike year. Id. His conclusions from the data are (*id.*):

(a) The price of coal delivered in 1979, 1980 and 1981 appears to be lowest for contracts entered into in the late 1950s and early 1960s.

(b) The price rises sharply for contracts entered into in the late 1960s and is still higher for contracts entered into in the early 1970s.

(c) Prices fall for deliveries pursuant to contracts entered into in 1975 or 1976 and then rise again but not always reaching the levels reached in the early 1970s.

(d) The price of coal appears to be lowest for contracts covering relatively small quantities of coal.

(e) Coal from underground mines tends to be more expensive than coal from surface mines.

(f) Longer term contracts are associated with higher delivered prices, at least in their earlier years.

Dr. Landon did a statistical analysis of this same data and found "statistically significant relationships between delivered prices and the date the contract was signed, the type of mine (underground or surface), the quantity of coal delivered, the duration of the contract and the year for which price is observed." Exh. 9H, page 15.

Mr. Pyrdol testified that Dr. Landon only used 48 contracts in one statistical analysis, and 24 in another. Exh. 13J, page 12. Also the data base contains a number of duplications. Id. at 13. Flaws in the data base, in Mr. Pyrdol's opinion, make the conclusions drawn by Dr. Landon unreliable. Id. at 13. Furthermore, even if it is assumed Dr. Landon is correct, the relationship between contract vintage and price merely supports the Staff determination that the Martinka prices were higher than the average market prices since many of the contracts used by Dr. Kleber were later than OPCO's commitment to the Martinka mine which means that Dr. Kleber averaged in contracts with higher prices by virtue of the vintage. Id. at 16.

As to this final point, Dr. Landon said that Mr. Pyrdol was not reading his exhibits correctly. His exhibits show "a negative relationship between price and contracts signed in [1979 and 1980]. Therefore, [Mr. Pyrdol's] conclusion that [Dr. Landon's] analysis shows that re-

cent contracts are associated with higher prices is inaccurate." Tr. 1513-14. Mr. Pyrdol gave very technical testimony as to why he disagreed with Dr. Landon. Tr. 151[illegible] 26. The testimony of Dr. Landon and Mr. Pyrdol on which conclusions can be made is not persuasive one way or other as to whether contracts signed in 1979 and 1980 were reflecting lower prices. Essentially what the record has is the opinion of two experts without a cogent explanation of those opinions which can be weighed by a lay person. There is no reason to believe one expert is correct and the other is incorrect.

Dr. Kleber takes issue with Dr. Landon's data base. Exh. 15RR, page 2. Instead of there being over 200 contracts covering deliveries to 21 of the 31 plants within 100 miles of Mitchell, the Staff found only 118 contracts for 26 of the 31 plants in the market area, and within this 118 number are some contracts covering supply to several different plants, and 22 contracts for coal outside the sulfur specification in Staff's market price analysis. Id.

As for Dr. Landon's conclusions on the relationship between contract vintage and contract prices, Dr. Kleber notes that Dr. Landon's study, where captive coal and contracts that only show a range of prices are included in the data base, shows the contracts signed in 1971 had the highest prices, but that the other study, where captive coal and contracts where only the range of prices is known are eliminated, has no consistent relationship between contract vintage and prices. Exh. 15RR, pages 5, 6.

Dr. Kleber did a study of his own data for the year 1981 and found the coal from underground mines in 1981 was less expensive than coal delivered from strip mines. Exh. 15RR, page 6. He says that Dr. Landon did not consider the amount of coal coming from the mines in his study. Id.

As to Dr. Landon's study on prices vis-a-vis contract duration, Dr. Kleber opines that the data Dr. Landon ended up with is confusing. Exh. 15RR, page 7.

It is difficult to weigh the conflicting opinions of Drs. Landon and Kleber and Mr. Pyrdol on the value of Dr. Landon's study. Since Dr. Landon's conclusions concerning the importance of contract vintage on prices are consistent with the real world as testified to by Mr. Renton, they are viewed in a positive light. However, if these conclusions had to be based on Dr. Landon's study, a closer analysis of the arguments pro and con would have to be made. This is not necessary since the persuasive evidence of Mr. Renton overrides any of the statistical analyses introduced into the record.

(4) Miscellaneous considerations

Dr. Landon has several relatively minor criticisms of Staff's choice of transactions, but, even accepting these criticisms, the difference in prices between those of the selected transactions and the Martinka price is substantial.

In summary his criticisms are:

(a) Inclusion of 13 mine-month plants (Exh. 9D, page 3): Dr. Landon argues that these prices are too low since there is no transportation cost as there would be if the coal was used at Mitchell.

(b) If the 100 miles market were expanded slightly it would include 3 additional plants and give a more realistic market (Exh. 9D, page 3): Dr. Landon states it would take a significant expansion beyond these 3 additional plants to include other additional plants and therefore the expansion he suggests gets to "a natural break in the chain of substitution." Id.

(c) Surface-mined coal should be excluded (Exh. 9D, page 3): Dr. Landon notes that even though generating

plants will perform equally well using deep or surface-mined coal if it is comparable in all respects, the market appears to distinguish between the two with prices "paid for deer-mined coal appear[ing] to be consistently higher." Id. at 4.

Dr. Landon calculated the changes in average prices as calculated by Dr. Kleber if his changes were made (Exh. 9F):

	Kleber			*Landon*		
	(cents per million Btu)					
1-4% Sulfur	*1980*	*1981*	*1982***	*1980*	*1981*	*1982***
50 miles market:	119.5	134.2	151.0	127.4	142.9	158.6
100 miles market:	121.8	135.9	149.3	143.0	149.0	163.9

** Dr. Landon's exhibit shows 1982 on a quarterly basis; the numbers used for 1982 above are the average of those shown for each quarter.

In short, even though Dr. Landon would calculate somewhat higher numbers there is still a wide margin between these average prices and those paid for the Martinka coal in 1980 (184.9), 1981 (268.7) and 1982 (206.8).

Dr. Kleber took issue with the criticisms and testified that even if the criticisms were correct the results would only slightly differ from these earlier results. Exh. 15RR, pages 1-5. Since the Staff's market prices are rejected on fundamental grounds it is not necessary to decide on what refinements, if any, would be made in market prices if they had been found otherwise acceptable.

Dr. Landon was critical of Dr. Kleber's study in that the prices used were those of coal delivered at locations other than Mitchell. The logical assumption can be made that the transportation costs for delivery to Mitchell would be something different. Dr. Kleber says this is a minor matter since transportation costs in general are only in the 9% range of the total price. Exh. 15RR, page 10. It might also be assumed that adjustments in transportation costs might wash out—those from certain mines would be more to Mitchell *vis-a-vis* the plant the coal was actually delivered to and vice versa. Id. at 11. This is a nice premise to start with but before anyone should be penalized such as Staff proposes here, something more than bare assumptions are needed. A 9% element in price is a significant factor, and some sort of study would have to be made before the prices of coal delivered to locations other than Mitchell could be equated with deliveries to Mitchell. Merely comparing what the market price might be with and without mine-mouth mines included is not a convincing study on this point. In the mine-mouth study it would be expected the transportation costs to Mitchell would be greater. Yet Staff's study showed that by excluding 8 mine-mouth plants in some years the average price relied upon by Staff went up and in one year it went down. Id. at 10. It is difficult to draw any conclusions from that comparison, except to say that something other than transportation costs has caused the difference. The fact that Staff relied on plants within 50 miles of the Mitchell plant in reaching its ultimate conclusions reduces the significance of this element; nonetheless it required a closer look than it received.

Dr. Kleber analyzed what he viewed as overcharges both from the perspective of 1-2% sulfur coal and 1-4%, with the lower sulfur coal being considerably more expensive *vis-a-vis* the Martinka coal and therefore reflecting, in Dr. Kleber's view, a smaller overcharge. The evidence as to the importance of the low sulfur coal for the Mitchell plant is not as complete as is the evidence showing the need for the high ash fusion temperature coal. Nonetheless the evidence shows that OPCO tries to burn 100% of the Martinka coal in Unit 2 at the Mitchell plant and that the Martinka coal has about 1.5% sulfur content. Exh. 3, page 43; Exh. 24; Tr. 176-79. Dr. Kleber testified that he decided upon the 4% level be-

cause of environmental requirements, but, in any event, the fact the Mitchell plant was acquiring coal with 4% sulfur content indicates it is operating with coal with that sulfur content. Tr. 1093. Since the overall analysis of Dr. Kleber is rejected on fundamental grounds it isn't necessary to decide whether the 1-2% or 1-4% sulfur coal would be the proper comparison.

OPCO argues that any comparison of Martinka prices with a calculated market price should be on the basis of a range of market price. OPCO Initial Brief, pages 169-71. OPCO's point is that otherwise it would be penalized on the basis of forced Martinka prices which in many cases were lower than those found in the market place between unrelated buyers and sellers. Other than to note that this argument has a persuasive ring to it, no further analysis is made since Staff's single market price is rejected.

The Municipals argue that even though Staff only seeks refunds for the year 1982 that refunds should also be made for the years 1980 and 1981. Muncipals Initial Brief, pages 72-77. Since no refunds are necessary this position need not be explored. However, any consideration of the year 1981 would have to take into account the unusual operational and strike factors that caused unusually high prices for Martinka coal in 1981.

The Municipals also argue that the 3.1% upward adjustment Dr. Kleber made in his market prices because the data came from Form 423 should not have been made and Dr. Kleber in essence said so in his testimony. Muncipals Initial Brief, pages 54-59. Dr. Kleber's testimony is not viewed as reneging on the adjustment he made, but rather to indicate he thinks it puts his calculated market prices on the conservative side. Tr. 1126, 1157. In any event this argument need not be pursued further since no refunds are necessary.

3. Conclusions

The Staff did not accomplish what it set out to do. Namely, it did not establish prices for coal "that can be used as substitutes for the coal presently being used to generate electricity at the Mitchell plant" by focusing "on independent, arm's length coal contracts being signed at the time of the captive contract and then [looking] at the present day prices of these contracts to establish a market price for the captive coal." Exh. 13, pages 12, 13. It focused on contracts in which prices did not necessarily take into account qualities found in the Martinka coal.

There is credible evidence of market prices for coal of comparable quality to Martinka coal for the years 1980 and 1981. Although they are only offered prices, the responses to the 1980, 1981 bid solicitations are the best evidence as to how the market place viewed Martinka quality coal. A comparison on the basis of an average of the bids, rather than with the lowest bids, gives a reasonable view of the market price in 1980 and 1981.

When the Martinka prices for 1980 and 1982 are compared to the average 1980 and 1981 prices reflected in the bid solicitations put out by AEPSC the Martinka prices do not look too bad. Subsection 2.b., *supra*. They are somewhat higher but this might be attributable to the soft market in 1980 and 1981 instead of any unreasonableness in the Martinka prices. This seems to be true since the unrebutted evidence is that OPCO was prudent in acquiring rights to the Martinka coal (Exh. 1, pages 4-6, 8-9), and that the Martinka mine has been efficiently developed and operated (Exh. 1, page 10; Exh. 4, pages 19-21; Exh. 5, pages 6, 7, 12, 13; Tr. 386,390).

From the vantage point of viewing the evidence and possible evidence after the hearing is over, it appears that there was relevant evidence of the market price of Martinka quality coal under "pre-existing contracts" which would result in a better feel for how good a deal

OPCO has in the Martinka mine compared to the deals others have been able to make for comparable coal over the years—for example, it would be enlightening to know what plants in the vicinity of the Mitchell plant were paying for coal with an ash fusion temperature of 2700 degrees, or what OPCO is paying for coal at the other plants which it says are similar to the Mitchell plant even if they rely on coals distant from Mitchell (Tr. 524). This leads to the next part of this decision and a discussion of the burden of proof.

VI. Burden of Proof

As discussed in Part IV, no one has established that OPCO's purchase of Martinka coal from its subsidiary places it in any worse position than it would have occupied if it had made a similar long-term arrangement for comparable coal circa 1972 with a non-affiliated coal supplier. Most of the evidence has been directed to showing that Staff's presentation wasn't relevant. However, from the evidence available, it appears that OPCO may have paid somewhat more for Martinka quality coal in 1980 and 1981 than it could have purchased it for from others albeit the offers of sale made in 1980 and 1981 were for shorter periods of time. On the other hand, it appears that further efficiencies in the operation of the Martinka mine plus more favorable transportation terms will make the Martinka prices more attractive in the future.

From a legal standpoint the question posed by these factual determinations is who has what burden of proof relative to the claim of excessive costs in the OPCO cost-of-service, and has the burden been carried.

The Staff argues that OPCO has the burden of showing that the proposed rates are just and reasonable. Staff Initial Brief, pages 5-8. The Staff buttresses its position by citations to cases holding that a burden is on a company to justify the fairness of contracts with affiliates. Id. OPCO takes the position that the burden is on those

challenging the prices paid for Martinka coal to show by clear and convincing evidence that the costs were not prudently incurred. OPCO Initial Brief, pages 12-14.

OPCO relies upon language found in Commission Opinion No. 731, 53 FPC 1691, 1703 (1975), which was adopted by Judge Harfeld in the Initial Decision of January 25, 1980. Although that decision became moot because of a settlement, Judge Harfeld recited the position he had taken in his later Initial Decision of November 28, 1980 (13 FERC at p. 65,169) which later decision was approved by the Commission in Opinion No. 133. See *the* discussion at III.C, *supra*.

Notwithstanding the Commission's approval of Judge Harfeld's decision of November 28, 1980, and the recital in that decision that the "Staff or any other challenger bore the burden of proving that the Company's costs were unreasonable," this recital was *dicta*. Judge Harfeld made his decision on the basis of affirmative evidence, not on the basis of a party failing to carry a burden of proof. *See* 13 FERC at p. 65,174. Hence, it isn't clear that the Commission intended in Opinion No. 133 to adopt Judge Herfeld's *dicta*.

There are Commission and court precedents that apply. In *Anaheim, Riverside, etc. v. F.E.R.C.*, 669 F.2d 700, 809 (D.C. Cir. 1981) the court said:

> The Federal Power Act imposes on the Company the "burden of proof to show that the increased rate of charge is just and reasonable." 16 U.S.C. § 824(e). Edison relies on Supreme Court precedent for the proposition that a utility's costs are presumed to be prudently incurred. *See Missouri ex rel. Southwestern Bell Telephone Co. v. Missouri Pub. Serv. Comm.*, 262 U.S. 276, 289 n.1 (1923). However, the presumption does not survive "a showing of inefficiency or improvidence." *West Ohio Gas Co. v. Public Utilities Comm.*, 294 U.S. 63, 55 S.Ct.

316, 79 L.Ed. 761 (1935); see 1 A.L.G. Priest, Principles of Public Utility Regulation 50-51 (1969). As the Commission has explained, "utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent. . . . However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent." Opinion No. 86, *Minnesota Power & Light Co.*, [11 FERC ¶ 61,312 at p. 61,645]. (Footnotes omitted.)

Here the Staff created a serious doubt as to the prudence of the prices paid for the Martinka coal; OPCO has convincingly erased that doubt but did this primarily by attacking the Staff's presentation rather than by an affirmative showing of prudence. OPCO put in some evidence going beyond merely responding to Staff's evidence, but there is undoubtedly additional evidence that would give a better picture as to how the Martinka prices compare with prices for comparable coal. Therefore, the question becomes whether OPCO has failed in carrying a burden of proof by not coming forward with additional evidence.

Considering the presumption that a utility's costs are prudently incurred, the rule cited by Judge Harfeld about the burden being on challengers, and the evidence that (a) the rights to the Martinka coal were prudently acquired, (b) the Martinka mine has been efficiently operated, (c) the prices of Martinka coal have shown a trend downward in constant dollars (Exh. 4., page 20), (d) that prices from newly developed mines wouldn't be much different than the cost of Martinka coal (Exh. 4, pages 35-37), (e) the projected price for Martinka coal discussed below, and (f) the market-price study performed by OPCO discussed below, whatever legal requirement is involved in the *Anaheim* decision about "dispelling these doubts and proving the questioned expenditure to have been prudent" has been satisfied by OPCO.

OPCO made a market-price study by identifying what was considered to be mines within 75 miles of the Mitchell plant which had coal comparable to the Martinka coal. Exh. 4, page 33. When the delivered prices of that coal (Tr. 514-15) are compared for the years 1980-1982 (Exh. 4K) with the Martinka coal price (listed as Southern Ohio on Exh. 4K), Martinka prices seem reasonable. The coal considered in the OPCO study was in the 1-2% surfur range; the following is a comparison of the weighted averages of the delivered prices shown on Exh. 4K with the price on Exh. 4K for Martinka coal, and the amounts Staff thinks OPCO overpaid for 1.2% coal:

Year	*Staff View of Overpayment (Exh. 15, pages 21-22; Exh. 15GG*	*Exh. 4K price for Martinka coal*	*Exh. 4K price on weighted average basis for other coal*	*Exh. 4K price spread*
1980	$10.47/ton	$44.10/ton	$37.21	$ 6.89
1981	$27.40/ton	$61.83/ton	$44.01	$17.82
1982	$ 5.86/ton	$49.09/ton	$55.17	—$ 6.08

Dr. Kleber took issue with OPCO witness Blackmore as to the seams from which coal burned in Mitchell must come. The OPCO market-price study was premised on the belief that only certain seams produced the quality coal needed at the Mitchell plant. Exh. 4, page 34, First, Dr. Kleber noted that coal offered in response to the 1980, 1981 bid solicitations for coal for the Mitchell plant come from a number of seams other than those identified by Mr. Blackmore; second, Pennsylvania State University identified four additional seams that produce "coal that meets the specifications of the 1980 bid solicitation and thus appears to be capable of being burned in Mitchell"; and third, purchase orders for coal for the Mitchell plant suggest additional seams. Exh. 15HH, pages 3-5. Dr. Landon testified that 70% of the additional seams identified by Dr. Kleber "appear to be out-

side . . . the 100 miles 'market' identified by Staff witnesses," and that he saw "no evidence in the record that coal from any of these seams is delivered to electric plants within the Staff designated 'markets'." Exh. 9D, page 12. Dr. Landon also noted that "there is no evidence that coal from these seams was available, and if it were available, at what cost." Id.

Mr. Blackmore did not respond in detail to Dr. Kleber's view about additional coal seams having suitable coal, but on cross-examination he indicated there were coals in "east Kentucky and southern West Virginia, which would comply with the specification of the coal [OPCO was] looking for," but his study did not look at those coals "because out of experience . . . the cost of coal is higher, and the transportation costs would make it uncompetitive." Tr. 520.

There are aspects of OPCO's market study which weaken the belief that comparable prices are being reflected, for example, the relatively small quantities of coal involved, but it is credible evidence that must be considered with all the other evidence in the record.

The Martinka coal price looks better for the future if the prediction made by Mr. Blackmore in his testimony holds up. He testified that the FOB mine price projected for 1983 for Martinka coal was $38.81 per ton Exh. 4, page 19. When compared to the FOB price in 1982 of about $43.24/ton, this is a significant decrease.[7] Mr. Blackmore attributes this decrease to efficient operation of the mine. Id. at 19, 20. Furthermore, a decrease in the transportation costs has been negotiated and this would also add to the decrease in the price delivered to the Mitchell plant. Id. at 21, 22.

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[7] The FOB mine price in 1982 is calculated from a price of 183.2¢/MMBtu testified to by Mr. Blackmore (Exh. 4, page 20) and the assumption the Martinka coal has 11,800 Btu/pound. The formula used is that sponsored by Dr. Kleber in Exh. 15A.

In summary, OPCO has shown by a preponderance of the evidence that over the years 1980-1982 the prices paid for Martinka coal were not unreasonable. The 1981 price for Martinka coal was much higher than the price coal could have been acquired for elsewhere, but the unique problems of that year that afflicted owners of mines rather than those having contract prices which were not affected by the over 2 month strike or peculiar operating problems is the explanation rather than an endemic unreasonableness in the price for the Martinka coal. Furthermore, a preponderance of the evidence shows that the Martinka price may be favorable compared to other market prices in at least the near future.

VII. Ultimate Determination

The inclusion of the prices paid for Martinka coal in the cost-of-service by Ohio Power Company for the years 1980-1982 was reasonable.

(Holding Company Act Release No. 17383)

Administrative Proceeding
File No. 3-3284

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

December 2, 1971

IN THE MATTER OF OHIO POWER COMPANY
Canton, Ohio

CAPTINA OPERATING COMPANY
Moundsville, West Virginia

(70-5090)

(Public Utility Holding Company Act of 1935)

ORDER AUTHORIZING ISSUE AND SALE OF COMMON STOCK BY SUBSIDIARY COMPANY AND ACQUISITION THEREOF BY PARENT UTILITY COMPANY

Ohio Power Company ("Ohio Power"), an electric utility subsidiary company of American Electric Power Company, Inc. ("AEP"), a registered holding company, and Captina Operating Company ("Captina"), a presently inactive wholly-owned subsidiary company of Ohio Power, have filed an application and an amendment thereto with this Commission pursuant to Sections 6(b), 9, and 10 of the Public Utility Company Act of 1935 ("Act") regarding the following proposed transactions.

Captina, a West Virginia corporation, organized in 1956 to, among other things, develop, mine, and sell coal and manage, operate, and maintain steam electric generating stations, has been inactive since December 31, 1966. Captina has 5,000 shares of common stock (par

value $1.00) authorized and 1,000 such shares outstanding and as of June 30, 1971, had total assets of $1,681. Upon authorization of the transactions proposed herein, the name of Captina will be changed to Southern Ohio Coal Company ("Southern Ohio") and Southern Ohio will take the necessary steps to qualify to do business in the State of Ohio and develop and mine such coal reserves either owned by Ohio Power, or which Ohio Power may transfer to it.

Ohio Power has under construction three 1,300.000 kilowatt coal-fired steam electric generating units. In order to assure a reliable supply of coal for these generating facilities, a financing program for Southern Ohio is proposed to permit it to develop and mine various reserves of coal owned or controlled by Ohio Power in southern and eastern Ohio. Southern Ohio proposes to issue and sell, on or before July 1, 1973, 4,000 shares of its common stock, and Ohio Power proposes to acquire such stock for a consideration of $2,500 per share ($10,000,000).

Ohio Power's three 1,300,000 kilowatt units will require in aggregate over 10 million tons of coal per year. It is stated that the most significant coal reserve to be developed and mined by Southern Ohio is Ohio Power's Wellston Coal Field, which has an estimated 270 million tons of recoverable coal. In addition to the Wellston reserve, Southern Ohio will initially commence development and mining of certain other coal reserves, which have an estimated 137 million tons of recoverable coal. All of these coal reserves must be "deep mined." None of the coal to be mined by Southern Ohio will be sold to anyone other than public utility companies in the AEP system.

It is estimated that the development of such coal reserves will require capital expenditures of approximately $20,000,000 through 1973. Additional financing requirements will be the subject of future applications. The charges for coal by Southern Ohio will be based on an amount equal to the actual cost of Southern Ohio in de-

veloping the reserve and mining such coal, including all appropriate overheads and interest charges and including a reasonable rate of return on Ohio Power's equity investment in Southern Ohio. Such rate of return will be no greater than the return then being earned by Ohio Power on equity invested in electric plant as determined pursuant to the then effective Uniform System of Accounts prescribed by the Federal Power Commission for electric utility companies.

No State commission and no Federal commission, other than this Commission, has jurisdiction over the proposed transactions.

Due notice of the filing of said application has been given in the manner prescribed in Rule 23 promulgated under the Act (Holding Company Act Release No. 17350), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate in the public interest and in the interest of investors and consumers that said application, as amended, be granted:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application, as amended, be, and it hereby is, granted, effective forthwith, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act and subject further to the proviso that nothing in this order shall be construed as in any manner affecting the jurisdiction of any other regulatory authority with respect to the accounting or similar matters in connection with the proposed transactions.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

RONALD F. HUNT
Secretary

PUBLIC UTILITY HOLDING COMPANY ACT OF 1931

Release No. 20515 / April 24, 1978

IN THE MATTER OF OHIO POWER COMPANY

SOUTHERN OHIO COAL COMPANY
Canton, Ohio

(70-6090)

ORDER AUTHORIZING TRANSFER OF INVESTMENT IN COAL MINING DEVELOPMENT AND ASSOCIATE FACILITIES FROM UTILITY TO COAL MINING SUBSIDIARY IN EXCHANGE FOR CASH AND LONG-TERM DEBT NOTES OF SAID SUBSIDIARY AND CAPITAL CONTRIBUTION FROM UTILITY TO SAID SUBSIDIARY IN CONNECTION THEREWITH

Ohio Power Company, ("Ohio"), an electric utility subsidiary company of American Electric Power Company, Inc. ("AEP"), a registered holding company and Southern Ohio Company ("SOhio"), a coal mining subsidiary company of Ohio, have filed an application-declaration and amendments thereto with this Commission, pursuant to Sections 6, 7, 9, 10 and 12 of the Public Utility Holding Company Act of 1935 ("Act") and Rule 50(a)(3) promulgated thereunder regarding the following proposed transactions.

SOhio is engaged in the development of coal reserve owned or controlled by Ohio. By order of this Commission (HCAR No. 17383, December 2, 1971) SOhio was authorized to issue and sell, and Ohio was authorized to acquire, 4,000 shares of SOhio's common stock for a consideration of $2,500 per share ($10,000,000). Pursuant to such order, Ohio has purchased 4,000 shares of SOhio's common stock. SOhio commenced the develop-

ment of the Meigs Mines, located in southeastern Ohio, in 1971. In order to further these activities Ohio itself subsequently engaged in mine development work and the construction of associated facilities both at the Meigs Mine complex and at the Martinka Mines. SOhio however, remained and still remains, the actual operator of these mines and facilities.

SOhio is developing Ohio's coal resources in order to assure a reliable supply of coal for Ohio's generating facilities in general, including the Mitchell Plant at Captina, West Virginia and the Ohio Electric Company's General James M. Gavin Plant at Cheshire, Ohio. The Gavin Plant, which is owned by Ohio Electric Company, wholly-owned subsidiary of Ohio, consists of two 1,300,000 kilowatt coal-fired steam electric generating units and receives coal from the Meigs Mine complex. Ohio's Mitchell Plant consists of two coal-fired generation units with a combined capacity of 1,460,000 kilowatts (Unit 1 is rated at 660,000 kw and Unit 2 is rated at 800,000 kw), and receives coal from the Martinka Mines. The Gavin Plant's annual coal requirement is 7.5 million tons per year, while the Mitchell Plant's need is 4.0 million tons. Coal being delivered to these respective plants from the Meigs Mines complex and the Martinka Mines conforms with the federal plan for sulfur dioxide emissions control. A large part of the 11.5 million tons of coal required annually for these units is being supplied from coal reserves owned by Ohio so as to assure an adequate and reliable fuel supply for these plants. The major coal reserves currently being developed by SOhio are the Wellston Reserve located in Meigs, Gallia and Vinton Counties, Ohio and the Hillman Reserve in Marion County, West Virginia. The combined reserves cover approximately 77,000 acres and have a total reserve base of 705,000,000 tons. The Wellston Reserve, currently being mined by SOhio's Meigs Division, consist of 60,229 acres with an estimated reserve base of 545,831,000 tons of coal from the Clarion 4-A seam. The

estimated recoverable clean reserve (reflecting current mining techniques and preparation plant operations) is approximately 212,874,000 tons of coal. The Hillman Reserve, currently being mined by SOhio's Martinka division, consists of 16,314 acres with an estimated reserve base of 159,149,000 tons of coal from the Lower Kittanning seam and with an estimated recoverable clean reserve of 71,090,000 tons.

It is proposed that Ohio convey its entire investment in coal mining development and associated facilities at the Meigs Mines complex and the Martinka Mines at its net book value as of the first day of the month in which the transaction is accomplished. As of March 1, 1978, the net book value of the property proposed to be transferred was $260,176,293. Included among the assets to be transferred are the Meigs overland conveyor connecting the Meigs Mines to the Gavin Plant, the intermine conveyor between Meigs Mine Nos. 1 and 2, preparation plants and related facilities, surface lands and mineral rights and development costs. Ohio also proposes to assign to SOhio all coal leases held in the Hillman Reserve at the Martinka Mines. Ohio shall continue to remain secondarily liable for such leases.

Certain issues with respect to these assets are involved in a suit filed by the Commission on March 3, 1978 (SEC v. AEP, et al., U.S.D.C., D.C. Civil Action No. 78-0384). The defendants, including Ohio, have agreed to a Consent Order and, pursuant to their Undertaking and Stipulation, will appoint a Special Auditor to investigate, *inter alia*,. acquisition of certain of these assets and or charges relating thereto. Upon completion of this investigation, the Special Auditor will issue a written report ("Special Auditor's Report") as to his findings and recommendations. Jurisdiction will be reserved to make any appropriate adjustments in light of the Special Auditor's Report.

It is further proposed that, in exchange for the conveyance of such investment by Ohio to SOhio, SOhio will

issue long-term debt notes and pay cash to Ohio, the cash portion to be offset by a capital contribution in an equal amount to be made by Chio to SOhio, so as to establish a debt-equity ratio in SOhio equal to the average debt-equity ratio of Ohio during the period such investment was made (combining for such purpose preferred stock and common equity), 52% long-term debt, 13% preferred stock, and 35% common equity.

The price at which SOhio coal is sold to AEP system companies will not exceed the cost therof to the seller. For this purpose, cost will include reasonable compensation for necessary capital which will be determined from Ohio's overall cost of capital by applying to the seller's capital represented by Ohio's investment being transferred to SOhio, as well as the investment previously made by Ohio in SOhio, whether debt or equity, a composite rate of return computed by applying to Ohio's average capital structure during the period 1971 to 1976, in which time investments were made, an interest rate on long-term debt equal to the weighted average of effective interest costs of Ohio's bond issues during this period (9.16%), a preferred dividend rate equal to the weighted average of effective dividend rates of Ohio's preferred stock issues during this period (9.70%) and a return on common equity not to exceed the rate of return on common equity specified by the Federal Energy Regulatory Commission (FERC) in the most recent wholesale rate proceeding involving Ohio. In the absence of such a determination at this time, it is proposed that the cost of common equity capital of SOhio be set at 13% until such time as FERC shall then become applicable on a prospective basis to the then total common equity investment of Ohio in SOhio. Applicants-declarants cite recent retail rate decisions by two state utility commissions involving other AEP system companies in which rates of return on common equity of 13%-13.5% were approved.

It is further stated that upon completion of the transfer of such investment SOhio will require approximately $10,000,000 from the proposed date of transfer to December 31, 1980, to complete the capital improvement program presently underway at the Meigs and Martinka Mines. Authorization therefor is also being sought for Ohio to make investments in SOhio from time to time on or before December 31, 1980, in an aggregate amount of $10,000,000.

The return on such additional investment as well as the investment previously made in SOhio by Ohio will be determined from Ohio's overall cost of capital by applying of such investments, whether debt of equity, a composite rate of return computed by applying to Ohio's capital structure as of the end of the year preceding the investment, an interest rate on long-term debt equal to the effective interest cost of Ohio's capital structure as of the end of the year preceding the investment, an interest rate on long-term debt equal to the effective interest cost of Ohio's last bond issue preceding the investment, a dividend rate on preferred stock equal to the effective dividend cost of Ohio's last preferred stock issue preceding the investment and a return on common equity as described above.

No state or federal commission, other than this Commission, has jurisdiction over the proposed transactions. Fees and expenses to be incurred in connection with the proposed transactions are estimated at $28,000.

Due notice of the filing of said application-declaration has been given in the manner prescribed in Rule 23 promulgated under the Act (HCAR No. 20274), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate

and in the public interest and in the interest of investors and consumers that said application-declaration, as amended, be granted and permitted to become effective:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application-declaration, as amended, be, and it hereby is, granted and permitted to become effective forthwith, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act, except that Ohio and SOhio shall file reports providing, as to activities during each quarter: (a) corporate balance sheets and income statements for SOhio, including descriptions of the operations and capital improvement program undertaken during the quarter; (b) the quantities of coal sold to each buyer, the price of such coal and the method used to compute the cost of coal sold; and (c) such other matters and in such form as may be requested by the Commission from time to time.

IT IS FURTHER ORDERED that jurisdiction be and hereby is reserved with respect to any adjustments made necessary by the Special Auditor's Report pertaining to acquisition of coal mining assets here involved and or charges relating thereto.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

GEORGE A. FITZSIMMONS
Secretary

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Release No. 21008/April 17, 1979

IN THE MATTER OF SOUTHERN OHIO COAL COMPANY
Moundsville, West Virginia

OHIO POWER COMPANY
Canton, Ohio

(70-6215)

ORDER AUTHORIZING FINANCING FOR COAL MINING SUBSIDIARY

Ohio Power Company ("Ohio Power"), an electric utility subsidiary of American Electric Power Company, Inc. ("AEP"), a registered holding company, and Southern Ohio Coal Company ("SOCO"), a coal mining subsidiary of Ohio Power, have filed with this Commission an application-declaration and amendments thereto pursuant to Sections 6, 7, 12(b), 12(c) and 12(f) of the Public Utility Holding Company Act of 1935 ("Act") and Rules 42, 45, 46 and 50 promulgated thereunder concerning the following proposed transactions.

SOCO is engaged exclusively in developing and mining coal reserves owned by Ohio Power and in supplying coal for use at Ohio Power's Mitchell Plant at Captina, West Virginia and at the General James M. Gavin Plant at Cheshire, Ohio, which plant is owned by Ohio Electric Company, a generating subsidiary of Ohio Power. Applicants-declarants seek authorization for a set of financial transactions involving the following:

(1) SOCO's borrowing up to $130,000,000 from a group of banks from time to time through December 31, 1980, pursuant to a term loan agreement ("Loan Agreement")

and issuing its promissory notes ("Notes") in connection with such borrowings;

(2) SOCO's applying the proceeds from such borrowings as follows:

(a) 52% of such amount to Ohio Power to prepay a portion of the promissory note of SOCO held by Ohio Power; and

(b) 48% of such amount to Ohio Power as a distribution from capital surplus with respect to SOCO's outstanding shares of common stock; and

(3) Applicants-declarants' executing various documents in connection with the borrowing, including a subordination agreement ("Subordination Agreement"), capital funds agreement ("Capital Funds Agreement") and a letter to the lending banks giving assurances as to continued ownership of certain assets.

The banks and the amounts of their proposed commitments are as follows:

Bank	Amount
Citibank	$30,000,000
Chase Manhattan Bank	20,000,000
Chemical Bank	20,000,000
Continental Illinois National Bank and Trust	20,000,000
Irving Trust Company	20,000,000
Manufacturers Hanover Trust Company	20,000,000
	$130,000,000

Each borrowing by SOCO under the Loan Agreement will be made pro-rata from among the banks in proportion to their respective commitment. The Notes evidencing such borrowings will mature in installments from March 31, 1980, through December 31, 1986, and will provide for installments totalling 15% of the principal amount thereof that is unpaid on December 31, 1980, in

each of the years 1981 through 1985 and 25% of such principal amount in 1986; such annual installments to be paid in equal quarterly amounts on March 31, June 30, September 30 and December 31 in each year. Interest on the unpaid principal balance of the Notes will be payable quarterly and at maturity at the rate per annum equal to 109% of Citibank's prime rate for 90-day loans to responsible and substantial commercial borrowers. Interest after the principal of the Notes shall have become due (whether by acceleration or otherwise) will be payable at a rate per annum equal to the greater of 6% of 2% plus Citibank's prime rate. Each bank shall also receive a commitment fee of ½ of 1% per annum on the daily average unused amount of the bank's commitment, computed from the date of the Loan Agreement.

The Notes will be prepayable, in whole or in part, at any time without premium or penalty. The Loan Agreement requires prepayment in the event the Coal Supply Agreement among SOCO, Ohio Power and Ohio Electric to the Capital Funds Agreement (which is discussed further below) should either cease to be fully enforceable or terminate. The Notes are also prepayable in full at the election of the banks upon the occurrence of certain events of default specified in the Loan Agreement.

To induce the Banks to enter into the Loan Agreement, applicants-declarants propose to enter into the Subordination Agreement with the banks which will provide that so long as any of the Notes remain outstanding, all indebtedness and obligations of SOCO to Ohio Power, including SOCO's 9.16% promissory notes in the principal amount of $142,721,664 due April 1, 2008 (the "9.16% Note"), shall be subordinate and junior in right of payment to all indebtedness of SOCO evidenced by the Notes. The Subordinate Agreement would not prevent SOCO from paying principal or interest on any indebtedness or obligations to Ohio Power as they become due as long as SOCO is not in default under the Loan Agreement or

the Notes, or unless such payments would result in such a default.

The proposed Capital Funds Agreement provides in substance that Ohio Power shall supply or cause to be supplied to SOCO such amounts of capital from time to time during the term of the Coal Supply Agreement as, when added to amounts received by it from other sources, will be sufficient to enable SOCO to pay when due all of its operating and other expenses, including any amount which SOCO may be required to pay for interest on all indebtedness (which would include the Notes) and on account of stated maturities of, and/or all required sinking fund payments and other regular amortization requirements applicable to such indebtedness (which would include the installments of principal on the Notes but not any amount applicable to principal which might become due in the event of acceleration of maturity of the Notes other than installments of principal which would have become due but for such acceleration). Any capital that Ohio Power may be required to supply to SOCO under the Capital Funds Agreement shall be furnished in cash in the form of (a) a capital contribution with respect to the common stock of SOCO and (b) a loan to SOCO evidenced by a promissory notes maturing not less than 20 nor more than 30 years from the date of issuance and bearing interest, payable semiannually, at a rate per annum equal to the effective interest cost of the latest series of first mortgage bonds issued by Ohio Power prior to the date of issuance of such note. The amounts of such capital represented by the capital contribution and by the loan, respectively, shall be in such proportions as at the time may be authorized by this Commission (or any successor regulatory authority).

SOCO proposes to apply 52% of the amount of each borrowing from the banks under the Loan Agreement to prepay a portion of the principal amount of its 9.16% Note held by Ohio Power and to pay the remaining 48%

of such amount as a distribution from capital surplus with respect to its outstanding shares of common stock, all of which are held by Ohio Power. Assuming the borrowing of the full $130,000,000, the effect on SOCO's capitalization (excluding current liabilities) as of June 30, 1978, would be as follows (in millions):

	Per Books 6/30/78	Adjustments	Pro Forma 6/30/78
Long-Term Debt:			
Note Payable to Ohio Power	$142.7	(67.6)	$ 75.1
Notes Payable to Banks	—	130.0	130.0
	$142.7		$205.1
Equity:			
Common Stock, including premium	$ 10.0		10.0
Other Paid-in Capital	117.6	(62.4)	55.2
Retained Earnings	7.4		7.4
	$135.0		$ 72.6
Total Capitalization	$277.7		$277.7

SOCO's present capitalization was created in compliance with this Commission's order of April 24, 1978 (HCAR No. 20515 in File No. 70-6090), which order approved the conveyance to SOCO of Ohio Power's entire investment in coal mining development and associated facilities at the Meigs Mines complex and the Martinka Mines at the net value of such assets on Ohio Power's books. The consideration of approximately $260,200,000 paid by SOCO for such assets consisted of the 9.16% Note and cash provided by a capital contribution from Ohio Power, in proportions calculated to establish a debt-equity ratio in SOCO equal to the average debt-equity ratio of Oho Power during the period that its investment in the assets transferred was made (52% long-term debt and 48% preferred stock and common equity).

The April 24, 1978, order also provided that the price at which coal is sold by SOCO to AEP system companies should not exceed SOCO's cost, including reasonable com-

pensation for necessary capital calculated in accordance with a formula prescribed in such order. Under the prescribed formula the rates of return allowed on the debt and equity component of Ohio Power's initial investment have been calculated to be 9.16% and 12.11%, respectively. These two rate result in a composite rate of 10.58% after federal income tax and 11.51% including a provision for federal income taxes at the rate of 13.8% (which is the minimum effective rate based upon a 46% tax rate and the maximum 70% investment tax credit offset).

It is stated that by increasing the amount of debt capital in SOCO (the interest on which is deductible for tax purposes) in relation to the amount of its equity capital, it is anticipated that the proposed borrowings under the Loan Agreement should, over its term, produce a net reduction in the cost of coal supplied by SOCO to AEP system companies. During periods when the prime rate is below 9.71%, the borrowers by SOCO would result in a reduction in the cost of coal, regardless of federal income tax effect.

During periods when the prime rate is 9.71% or above, any reduction in the cost of coal would depend on the effective tax rate applicable to SOCO. Assuming an effective tax rate of 13.8%, the "break-even" prime rate under the proposal is 10.56%.

It is proposed that during months in which the average prime rate applicable is in excess of 10.5%, SOCO would use a cost of capital component, including provision for federal income taxes, of 11.51%, to be applicable to the total capital of SOCO, including term loans outstanding. During months in which the average prime is 10.5% or less, SOCO would use the actual borrowing cost applicable to the term loans and a cost of capital, including provision for federal income taxes, of 11.51%, applicable to the debt and equity capital provided by Ohio Power.

It is stated that under these conditions the cost of coal sold by SOCO would not include costs of capital that were in excess of the amounts currently authorized in File 70-6090, and, during the periods when the prime rate had declined to more normal historical levels, the result would be substantial reductions in the effective cost of coal. It is further stated that the price of coal supplied by SOCO to AEP system companies, including Ohio Power, shall not include a cost of capital with respect to the total debt (including the Notes) and equity of SOCO in excess of the presently allowed composite rate of 10.58% after taxes. SOCO will not defer, through a memorandum account or otherwise, its capital costs in excess of the allowable rate of return, or charge such excess costs to the cost of coal in any subsequent period.

In addition to a possible coal price reduction, the proposed transactions, through the prepayment of part of the 9.16% Note and the payment of a distribution of capital surplus on SOCO's common stock, would provide Ohio Power with funds for the repayment of short-term debt and for construction purposes. The receipt of such funds would reduce commensurately Ohio Power's financing requirement during a period in which it is anticipated that Ohio Power may be restricted in its ability to raise capital through the issuance of first mortgage bonds (it presently lacks the 2.0 interest coverage required for such issuance, a condition expected to continue well into 1979) as a result of delays in receiving adequate rate increases. Ohio Power states that its estimated external financing requirements for 1979 aggregate approximately $210,000,000, including $40,000,000 of maturing first mortgage bonds. Its present anticipated resources for the net $170,000,000 needed consist of a possible $40,000,000 sale of preferred stock (which will be the subject of a future application to this Commission) and a proposed $50,000,000 cash capital contribution from AEP, which was authorized by Commission order dated December 29, 1978 (HCAR No. 20865).

Applicants-declarants state that they consent to a provision to the effect that the borrowings by SOCO under the Loan Agreement shall be prepaid on or before December 31, 1979, unless such borrowings are permitted for a longer period by further Commission order.

The fees and expenses to be incurred in connection with the proposed transactions are estimated at $7,000, including legal fees of $2,500. The Public Utilities Commission of Ohio has authorized the proposed transactions. No other state commission and no federal commission, other than this Commission, has jurisdiction over the proposed transactions.

Due notice of the filing of said application-declaration has been given in the manner prescribed in Rule 23 promulgated under the Act (HCAR No. 20802), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate in the public interest and in the interest of investors and consumers that said application-declaration, as amended, be granted and permitted to become effective:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application-declaration, as amended, be, and it hereby is, granted and permitted to become effective forthwith, except that the Notes shall be prepaid on or prior to December 31, 1979, unless the borrowings are permitted for a longer period by further order of this Commission, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

GEORGE A. FITZSIMMONS
Secretary

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
Release No. 21537/April 25, 1980

In the Matter of SOUTHERN OHIO COAL COMPANY
Moundsville, West Virginia

OHIO POWER COMPANY
Canton, Ohio

(70-6409)

ORDER AUTHORIZING PROPOSED FINANCING FOR COAL MINING SUBSIDIARY

Ohio Power Company ("Ohio Power"), an electric utility subsidiary company of American Electric Power Company, Inc. ("AEP"), a registered holding company, and Southern Ohio Coal Company ("SOCO"), a coal mining subsidiary of Ohio Power, have filed an application-declaration and amendments thereto with this Commission, pursuant to Sections 6, 7, 9, 10 and 12 of the Public Utility Holding Company Act of 1935 ("Act") and Rule 50 promulgated thereunder concerning the following proposed transactions.

SOCO is engaged in the development and mining of coal reserves for use at Ohio Power's Mitchell Plant located in Captina, West Virginia, and at its General James M. Gavin Plant, located in Cheshire, Ohio. The transaction proposed herein involves the installation by SOCO of additional coal preparation facilities at its Meigs Mine Complex located in Gallia and Meigs Counties in southeastern Ohio. SOCO proposes to 1) install at Meigs Mine No. 1 a heavy-medium cyclone and a froth flotation system to augment the heavy-medium bath preparation; 2) install at Racoon Mine No. 3 a froth flotation system; and 3) modify the Baum jig plant at Racoon Mine No.

3. These additions and modifications are estimated to cost approximately $40,600,000.

Ohio Power and SOCO believe that the cost of the proposed project is justifiable on the basis of the anticipated savings in the cost of coal delivered to Ohio Power. In the case of Meigs Mine No. 1, the preparation plant additions will lead to improved quality of the coal and to a relative reduction in the cost per million British thermal units ("MBtu") of delivered coal. It is estimated that such cost in present-day dollars will be reduced from $181.75 per MBtu to $175.61 per MBtu. The Racoon Mine No. 3 addition will cause an increase in Btu recovery and an estimated decline in relative delivered cost per MBtu in present-day dollars from $170.98 to $157.77. The annual savings in delivered fuel costs alone upon completion of the proposed projects are estimated to be approximately $16,674,000 at capacity or planned output. Additional savings will accrue annually to Ohio Power through improved availability and lower maintenance expense of the Gavin Plant boilers. Although these savings are difficult to quantify precisely, they are conservatively estimated at $10 million annually. It is proposed that these projects will be financed through a combination of long-term loans and cash capital contributions by Ohio Power to SOCO of $40,600,000. It is expected that Ohio Power will make its investment in SOCO in two increments, one to be made in 1980 and the second to be made sometime in 1981. In return for the loans, SOCO will issue to Ohio Power long-term promissory notes. Each of the notes will mature and become payable on December 31, 2009.

The price at which SOCO's coal will be sold to AEP system companies will not exceed the cost thereof to the seller. For this purpose, cost will include reasonable compensation for necessary capital.

The investments made by Ohio Power in SOCO will be assumed to be made in the same proportion as the debt-

equity ratio of Ohio Power at the end of the year prior to the investment. As of December 31, 1979, the debt-equity ratios of Ohio Power were 56.3% long-term debt, 11.9% preferred stock, and 31.8% common equity. The interest rate on long-term debt will be equal to the effective interest cost of Ohio Power's last issue of First Mortgage Bonds prior to the investment, the preferred dividend rate will be equal to the dividend rate of Ohio Power's last issue of preferred stock prior to the investment, and the return on common equity will not exceed the rate of return on common equity specified by the Federal Energy Regulatory Commission (FERC) in the most recent wholesale rate proceeding involving Ohio Power. In the absence of such a determination at this time, it is proposed that the cost of common equity capital of SOCO be set at 13% until such time as FERC should take action specifying a rate of return in a wholesale rate proceeding involving Ohio Power in which case the rate then established by FERC shall then become applicable on a prospective basis to the then total common equity investment of Ohio Power in SOCO. The allowed rate of return on common equity shall not be applied to any of SOCO's retained earnings. No return allowance will be applied to such retained earnings.

It is stated that the issuance of such securities is excepted from the competitive bidding requirements of Rule 50 by reason of paragraph (a)(3) thereof.

The fees and expenses to be incurred in connection with the proposed transactions are estimated at $2,500. No state commission and no federal commission, other than this Commission, has jurisdiction over the proposed transactions.

Due notice of the filing of said application-declaration has been given in the manner prescribed in Rule 23 promulgated under the Act (HCAR No. 21499), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is

hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate and in the public interest and in the interest of investors and consumers that said application-declaration, as amended, be granted and permitted to become effective:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application-declaration, as amended, be, and it hereby is, granted and permitted to become effective forthwith, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

GEORGE A. FITZSIMMONS
Secretary

THIS INDENTURE, dated as of the first day of October, 1972, by and between Ohio Power Company, an Ohio corporation (hereinafter referred to as "Power Company"), and Southern Ohio Coal Company, a West Virginia corporation duly qualified in Ohio (hereinafter referred to as "Coal Company").

WITNESSETH:
THAT,

WHEREAS, Power Company and/or Coal Company have acquired, are now acquiring and expect to acquire in the future, ownership or control of large areas of land situate in the counties of Meigs, Gallia and Vinton, and in other counties in the State of Ohio, and elsewhere, which lands are underlain with bituminous coal; and

WHEREAS, Coal Company was organized for the purpose, among other things, of mining, producing, transporting, and selling coal; and Coal Company desires the right and privilege of mining and selling coal from the said lands of Power Company; and

WHEREAS, Power Company requires large quantities of coal in the conduct of its business; and Power Company is willing to grant to Coal Company the right and privilege of mining and selling coal from the lands of Power Company provided Coal Company will sell to Power Company, and/or to any subsidiary corporation of Power Company or any affiliated corporation of the American Electric Power System designated by the Power Company, the entire output of coal from both Power Company's and Coal Company's lands.

NOW, THEREFORE, for and in consideration of the sum of Ten Dollars ($10.00) and other good and valuable considerations in hand paid by Coal Company to Power Company, the receipt of all of which is hereby acknowledged, and subject to the covenants, conditions,

terms and agreements hereinafter set forth, Power Company hereby grants unto Coal Company the right and privilege to mine, extract, remove, prepare and to sell for its own benefit and profit all of the coal in and underlying certain lands of Power Company situate in the counties of Meigs, Gallia and Vinton and in other counties in the State of Ohio and elsewhere, to be more particularly designated and described as hereinafter set forth; together with the right to enter upon said lands and to construct, operate and use thereon all such works, buildings, plants, structures, equipment, machinery and appliances as may be necessary, useful or convenient for the mining, preparation and transporting of the coal; also the right to do anything in and upon said lands that may be necessary, useful, convenient and proper in the exercise of the rights and privileges herein granted.

The rights and privileges herein granted shall continue for a period of 35 years from and after the date hereof and from year to year thereafter.

This indenture shall not be terminated by either party for a period of 35 years from and after the date hereof for any reason whatsoever except to the extent that performance may conflict with any rule, regulation, or order of the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935. Either party hereto shall have the right to terminate this indenture at the end of 35 years after the date hereof by giving to the other party written notice of its intention so to do at least ninety (90) days prior to the date of such termination.

The parties hereto hereby covenant and agree as follows:

1. Power Company will, from time to time, designate in writing such lands it owns or controls that are to be subject to the terms and provisions of this indenture. Such written designations shall be in sufficient detail to

enable Coal Company to identify the lands, and to ascertain the extent of Power Company's ownership or control of the lands therein designated and described. Such written designations shall be signed by the duly authorized officers of Power Company, and delivered to Coal Company; and they shall be identified as being supplemental to this indenture. Title to coal mined by Coal Company from lands owned by Power Company shall, upon severance from the land, pass to Coal Company.

2. Coal Company shall sell and deliver to Power Company, and Power Company shall receive, accept and pay for all of the coal produced by Coal Company from the lands owned or controlled by Power Company or by Coal Company during the continuance of this indenture. Power Company shall have the right to designate any of its subsidiary corporations and/or any affiliated corporations of the American Electric Power System to receive, accept and pay for any portion of such coal, but this shall not relieve Power Company of its obligation to make payments for coal required hereunder.

3. The price to be paid by Power Company to Coal Company for the coal sold and delivered hereunder shall be an amount of money equal to the entire cost to Coal Company of mining, preparing and delivering such coal, including, but not limited to, depreciation, lease payments, amortization, the cost of developing the reserves, all appropriate overheads and interest charges, and including a reasonable rate of return, after taxes payable by Coal Company, on Power Company's equity investment in Coal Company, which will be no greater than the return then being earned by Power Company on equity invested in electric plant as determined pursuant to the then effective uniform System of Accounts prescribed by the Federal Power Commission for electric utility companies.

4. Payments for the coal sold and delivered hereunder shall be made by Power Company on or before the twen-

tieth (20th) day of each month for all coal delivered during the preceding month. Notwithstanding the foregoing, if, for any reason whatsoever Coal Company shall fail in any month to sell and deliver tonnage of coal to Power Company sufficient to pay the entire cost of Coal Company for such month, Power Company shall pay as advance payment for coal the amounts necessary for Coal Company to meet its entire costs for such month.

In the event of non-performance by either party due to circumstances, in the judgment of the parties, are such as to excuse unconditionally all future performances by such party, this indenture shall terminate. In the event of such termination or of any other termination, by breach or otherwise, of this indenture by either party, Power Company shall pay any cost of Coal Company which may arise by reason of such termination.

5. Coal Company shall maintain and keep a complete record of the number of tons of coal mined and sold from the lands of both Power Company and Coal Company. Coal Company shall also establish and maintain a set of accounts, satisfactory in form to Power Company, showing the actual cost to Coal Company of mining, preparing and delivering the coal hereunder. Such records and accounts shall be available for examination by Power Company at all reasonable times.

6. Power Company shall supply or cause to be supplied to Coal Company such amounts of capital as shall be required in connection with the development of the coal reserves, including all related facilities necessary for the mining, cleaning, storing and transportation of the coal to be minded, to provide for pre-operating expenses of Coal Company, and to permit continuation of the mining, preparation and delivery of coal hereunder.

7. Coal Company shall not assign the rights and privileges herein granted, in whole or in part, without the written consent of Power Company.

8. Coal Company shall not use its lands or those of the Power Company, nor permit the same to be used,

in any illegal way or for any illegal purpose; and, in the conduct of its operations upon such lands, Coal Company shall comply with all applicable laws, rules and regulations of governmental bodies having jurisdiction in the premises. Coal Company shall also use mining methods conforming to best industry practice in the circumstances and take action necessary and required to minimize environmental effects.

9. Coal Company shall and will indemnify and save harmless Power Company from and against all claims for injuries, including death, or damage to any person or property by reason of the violation of any provision of this indenture, or which may arise out of the exercise of any of the rights and privileges herein granted, or any acts or omissions of Coal Company, its employees, agents or contractors. Coal Company shall furnish and maintain during the continuance of this indenture, and in form satisfactory to Power Company, policies of insurance covering the risk of claims for injuries or damages as aforesaid; but all premiums paid or payable by Coal Company for such policies of insurance shall be included in the cost to Coal Company of mining, preparing and delivering coal hereunder, and shall become a part of the price to be paid by Power Company for coal as hereinbefore provided.

IN WITNESS WHEREOF, the parties hereto have caused their corporate names to be hereunto signed and their corporate seals to be hereunto affixed and attested by their proper officers thereunto duly authorized, this the day and year first above written.

Attest:

/s/ [Illegible]

OHIO POWER COMPANY

By /s/ G. V. Patterson
Vice President

Attest:

/s/ [Illegible]

SOUTHERN OHIO COAL COMPANY

By /s/ [Illegible]
Vice President

AEP
OHIO
POWER

April 24, 1989

Ms. Lois Cashell
Secretary
Federal Energy Regulatory Commission
825 North Capitol Street, N.E.
Washington, D.C. 20426

Dear Secretary Cashell:

On April 30, 1987, the Federal Energy Regulatory Commission issued an order in FERC Docket Nos. ER82-553-000 and ER82-554-000 (Opinion No. 272). This order reversed an initial decision concerning the reasonableness of Ohio Power Company's (OPCo) purchases of coal from an affiliate, and ordered OPCo to refund the difference between amounts collected subject to refund and amounts payable under the revised rates. By its Opinion No. 272-A, the Commission denied rehearing on this matter.

On May 6, 1988, OPCo refunded, including interest, $2,372,105.29 to its 15 municipal customers (Municipals) for the billing period December 28, 1982 through February 29, 1988. Beginning April 1, 1988, their bills reflected the new rates. Due to the time lag of receiving FERC Form 423 data (approximately 3 months after month closing), a refund of $23,528.40 including interest for March 1988 was not issued until June 3, 1988.

On May 6, 1988, OPCo refunded, including interest, $10,394,222.88 to Wheeling Power Company (WPCo) for the billing period July 29, 1982 through January 31, 1988. Beginning April 1, 1988, Wheeling's bill reflected the new rates. The FERC Form 423 time lag as well as a billing lag different than that for the municipals, required a refund including interest of $91,838.87 for February and $82,357.83 for March 1988, issued on June 3, 1988 and July 5, 1988, respectively.

Subsequent to the refunds made pursuant to its May 6, 1988 filing, OPCo submitted a Revised Compliance Filing that corrected certain errors in the refund calculations. Additional refunds were made to the Municipals and WPCo in the amount of $68,990.81 and $328,998.70, respectively, on September 16, 1988.

On February 22, 1989, the Federal Energy Regulatory Commission issued an Order in FERC Docket Nos. ER82-553-004 and ER82-554-004.

The Order directed OPCo to recalculate the refunds due to the municipal customers and WPCo, and to resubmit its Compliance Filing reflecting revised calculations, in accordance with that Order.

The total refund supported by this Revised Compliance Filing is as follows:

	Refunds thru July, 1988	Sep. 16, 1988	Total Refunds Paid	Amount of Excess Refunds
Municipals	$ 2,395,633.69	$ 68,990.81	$ 2,464,624.50	$ 571,250.14
WPCo	10,568,419.58	328,988.70	10,897,408.28	2,816,851.85

Attached to this letter are the following items:

1) Service List;

2) A Form of Notice suitable for publication in the Federal Register;

3) Volume I, consisting of a summary and detail calculations of refunds to the Municipals; computed as the difference between the actual fuel clause billings and the billings that would have occurred had OPCo substituted market prices for captive prices in the calculation of the Fuel Adjustment clause;

4) Volume II, consisting of the Market Price calculations and supporting details including the price of contract coal delivered at each of the plants

within a 50 mile radius of the Mitchell Plant, with supporting Form No. 423 line and page numbers, and the calculations of the weighted average costs of coal at the Mitchell Plant reflecting those market prices.

5) Volume III, consisting of a summary and detail calculations of refunds to WPCo; computed as the difference between the actual fuel clause billings and the billings that would have occurred had OPCo substituted market prices for captive prices in the calculation of the Fuel Adjustment clause;

6) Volume IV, consisting of the Market Price calculations and supporting details including the price of contract coal delivered at each of the plants within a 50 mile radius of the Mitchell Plant, with supporting Form No. 423 line and page numbers, and the calculations of the weighted average costs of coal at the Mitchell Plant reflecting those market prices.

Upon approval by the Commission of the substitute refund calculations, Ohio Power will institute a monthly surcharge calculated to recover the excess refunds over a one-year period.

Copies of this Revised Compliance Filing have been sent to the Public Service Commission of West Virginia and the Public Utilities Commission of Ohio, as well as the other individuals indicated on the attached service list.

Correspondence or communications with respect to this submittal should be addressed to:

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Respectfully submitted,

/s/ R. J. Pelger
R. J. PELGER
Tariffs, Rates &
Contracts Director

RJP:vac
Enclosures

(10)

Supreme Court, U.S.
FILED
MAY 25 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-1283

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF OF PETITIONERS

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May 25, 1990

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether Section 318 of the Federal Power Act preserves the Federal Energy Regulatory Commission's authority over rate matters unless there is an actual conflict in the obligations of an electric utility created by a requirement imposed by the FERC and a requirement imposed by the Public Utility Holding Company Act or by the Securities and Exchange Commission acting pursuant to PUHCA.

2. Whether the FERC is entitled to judicial deference in interpreting Section 318 of the Federal Power Act, a provision within the Commission's organic statute, even though that particular section of the Act concerns the FERC's jurisdiction.

LIST OF PARTIES

A list of parties was provided at page ii of the petition for certiorari.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1283

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari
to the United States Court of Appeals
for the District of Columbia Circuit

BRIEF OF PETITIONERS

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-28a) is reported at 880 F.2d 1400 (D.C. Cir. 1989). The decision of the Federal Energy Regulatory Commission (FERC) (Pet. App. 31a-67a) is reported at 39 FERC ¶ 61,098 (1987). The decision of the FERC denying rehearing (Pet. App. 68a-73a) is reported at 42 FERC ¶ 61,046 (1988).

JURISDICTION

The court of appeals rendered its judgment July 28, 1989. Rehearing was denied October 12, 1989. See Pet. App. 29a-30a. The petition for a writ of certiorari was filed February 9, 1990, and was granted March 26, 1990. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 318 of the Federal Power Act of 1935 (FPA) provides in relevant part:

> **Conflict of Jurisdiction.** If, with respect to the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 or of a rule, regulation, or order thereunder and to a requirement of this chapter or of a rule, regulation, or order thereunder, the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this chapter, or of any rule, regulation, or order thereunder, with respect to the same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this chapter shall apply to such person. 16 U.S.C. § 825q.

Section 205(a) of the FPA provides in relevant part:

> All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful. 16 U.S.C. § 824d(a).

Section 206(a) of the FPA provides in relevant part:

> Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. 16 U.S.C. § 824e(a).

Section 13(b) of the Public Utility Holding Company Act (PUHCA) provides in relevant part:

> After April 1, 1936, it shall be unlawful for any subsidiary company of any registered holding company or for any mutual service company, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, to enter into or take any step in the performance of any service, sales or construction contract by which such company undertakes to perform services or construction work for, or sell goods to, any associate company thereof except in accordance with such terms and conditions and subject to such limitations and prohibitions as the Commission by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies. 15 U.S.C. § 79m(b).

STATEMENT

Petitioners are fifteen small Ohio villages and cities that purchase wholesale electric power from respondent Ohio Power Company for resale to their residents.[1] Ohio Power is owned by a registered public utility holding company, the American Electric Power Company

[1] Petitioners include the Villages of Arcadia, Bloomdale, Carey, Cygnet, Deshler, Greenwich, Ohio City, Plymouth, Republic, Shiloh, Sycamore, and Wharton, and the Cities of Bryan, St. Clairsville, and Wapakoneta. Petitioners have populations ranging from approximately 300 to 8500.

(AEP). The principal element of Ohio Power's operating expenses is coal, which it purchases under contract from its own wholly-owned subsidiary, the Southern Ohio Coal Company (SOCCO). The Federal Energy Regulatory Commission (FERC) has found the coal prices paid by Ohio Power under that contract to be substantially in excess of market prices. The FERC held that Ohio Power could not pass those inflated costs on to its wholesale customers, including petitioners, in its electric rates. The principal question in this case is whether, under Section 318 of the Federal Power Act (FPA), the jurisdiction of the Securities and Exchange Commission (SEC) over the transactions between Ohio Power and SOCCO deprives the FERC of its authority to hold that Ohio Power's rates are unjust and unreasonable because its coal costs are excessive.

1. *The Regulatory Context.* At the heart of this dispute is the comprehensive dual system of federal utility regulation created by Congress in the Public Utility Act of 1935. Title I of that Act, also known as the Public Utility Holding Company Act of 1935 (PUHCA), gives the SEC jurisdiction over certain transactions among registered public utility holding companies and their subsidiaries and affiliates, including public utility operating companies. Title II of the Act, also known as the Federal Power Act (FPA), grants the FERC (as successor to the Federal Power Commission (FPC) (see 42 U.S.C. §§ 7172(a)(1)(B), 7293)) jurisdiction over the transmission and sale at wholesale of electric power in interstate commerce, including the interstate transmission and sale of electric power by public utilities that are owned by holding companies. See FPA § 201(b), 16 U.S.C. § 824(b). Thus, under the statutory scheme of the Public Utility Act, the SEC and the FERC have dual jurisdiction over certain activities of public utilities owned by holding companies.

Because Ohio Power sells electricity at wholesale in interstate commerce, it is subject to regulation by the

FERC under the FPA. FPA § 201(b)(1), 16 U.S.C. § 824(b)(1). Section 201(a) of the FPA declares that "Federal regulation of . . . the *sale* of [electric] energy at wholesale in interstate commerce is necessary in the public interest." 16 U.S.C. § 824(a) (emphasis added). Accordingly, the FPA vests broad and comprehensive ratemaking authority in the FERC. Section 205(a) contains the classic "just and reasonable" standard of ratemaking: "All rates and charges . . . for or in connection with the . . . sale of electric energy subject to the jurisdiction of the [FERC] . . . shall be just and reasonable." 16 U.S.C. § 824d(a). Section 206(a) grants the FERC broad authority to set rates in accordance with this standard, and also to determine whether "any . . . contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential" and, if so, to abrogate or modify that contract. 16 U.S.C. § 824e(a). To protect the FERC's ability to ensure just and reasonable rates, the FPA also grants the FERC authority over accounting and record-keeping (FPA § 301(a), 16 U.S.C. § 825); major transactions, such as the sale or disposition of utility facilities (FPA § 203(a), 16 U.S.C. § 824b); major financing transactions, including issuance of securities, guarantees, and assumptions of liabilities (FPA § 204(a), 16 U.S.C. § 824c(a)); and interlocking directorates (FPA § 305(b), 16 U.S.C. § 825d(b)).

Because it is part of a registered public utility holding company system, Ohio Power, along with AEP itself and all other direct and indirect subsidiaries of AEP, is also subject to regulation by the SEC under PUHCA. PUHCA's purpose was to "meet the problems and eliminate the evils . . . connected with public-utility holding companies." PUHCA § 1(c), 15 U.S.C. § 79a(c). Many of PUHCA's provisions are designed primarily to regulate the finances, management and capitalization of public utility holding companies and their subsidiaries to protect both investors and consumers. Accordingly,

the SEC has authority over, among other things, the issuance and sale of securities (PUHCA § 7, 15 U.S.C. § 79g); acquisitions of securities or utility assets (PUHCA § 10, 15 U.S.C. § 79j); the filing of reports (PUHCA § 14, 15 U.S.C. § 79n); certain financing transactions involving the extension of credit (PUHCA § 12, 15 U.S.C. § 79l); accounting and recordkeeping (PUHCA § 15, 15 U.S.C. § 79o); and interlocking directorates (PUHCA § 17(c), 15 U.S.C. § 79q(c)).

Section 13(b) of PUHCA authorizes the SEC to regulate contracts among subsidiaries of public utility holding companies. 15 U.S.C. § 79m. It was designed to avoid "excessive charges" incurred as a result of inter-affiliate contracts. PUHCA § 1(b)(2), 15 U.S.C. § 79a(b)(2). Indeed, such contracts are prohibited unless they comply with "such limitations and prohibitions as the [SEC] by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers." 15 U.S.C. § 79m. In promulgating these regulations, the SEC is "to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, and fairly and equitably allocated among such companies." *Id.* SEC Rule 90 incorporates the "at cost" criterion of Section 13(b) by prohibiting sales and service contracts "at *more* than cost." 17 C.F.R. § 250.90(a)(2) (1989) (emphasis added).[2] In contrast to the FERC's responsibility under the FPA to ensure that rates (including the costs to be passed on to the customer) are "just and reasonable," the SEC has no responsibility or authority to ensure that the costs passed on to consumers are "just and reasonable."

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[2] Rule 90 also provides, however, that the sale of seller-produced goods need not be limited to cost (17 C.F.R. § 250.90(d)(2)), and Rule 92 provides that contracts for seller-produced goods cannot exceed "the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere," 17 C.F.R. § 250.92(b).

Because of the overlapping authority granted to the SEC under PUHCA and to the FERC under the FPA, Congress provided in Section 318 of the FPA a mechanism for resolving conflicts between these two regulatory regimes. The precise scope of that provision is the principal issue presented in this case.

2. *The Coal Contract Between Ohio Power And SOCCO.* This dispute arises as a result of a contract between Ohio Power and its wholly-owned subsidiary, SOCCO, under which Ohio Power purchases coal for generating electricity. See J.A. 97. Coal costs are the dominant component in the total cost of producing electricity from coal-fueled generators. In this case, for example, coal costs account for nearly half of Ohio Power's charges for electric sales to petitioners. See Ohio Power Co., Revised Compliance Filing, Docket No. ER82-553-004 (FERC Apr. 24, 1989).

PUHCA does not require the SEC to review and approve the Ohio Power-SOCCO contract, nor has the SEC done so. Ohio Power and SOCCO, however, have engaged in certain capitalization transactions that required and received SEC approval. Each time, the SEC issued a perfunctory order approving the financing transaction and incorporating or paraphrasing certain language concerning coal costs from the application. In 1971, the SEC issued an order approving the sale and purchase of SOCCO's stock. The order stated that the charges for coal under the Ohio Power-SOCCO contract would be "based on" actual costs. *Ohio Power Co.*, HCAR No. 17383 (Dec. 2, 1971) (J.A. 76). The next order, issued in 1978, authorized further investment by Ohio Power in SOCCO. It indicated that the price of coal "will not exceed the cost thereof to the seller." *Ohio Power Co.*, HCAR No. 20515 (Apr. 24, 1978), 14 S.E.C. Docket 928, 929 (J.A. 79). Subsequently, in 1979, the SEC entered an order noting that Ohio Power would pay *less* than the actual cost of coal if its after-tax capital costs exceeded a certain level. *Southern Ohio Coal*

Co., HCAR No. 21008 (Apr. 17, 1979) (J.A. 85). The most recent order, however, recited that "[t]he price at which SOCCO's coal will be sold to AEP system companies will not exceed the cost thereof to the seller." *Southern Ohio Coal Co.*, HCAR No. 21537 (Apr. 25, 1980) (J.A. 93).

None of these statements purported to require Ohio Power to purchase coal from SOCCO, or to pay any particular price for SOCCO's coal. Nor did they mention Section 13(b) of PUHCA. Most important, none of the orders contained any finding that the costs to be incurred under the SOCCO contract were "just and reasonable" from the standpoint of Ohio Power's customers, or on any other basis.

3. *Proceedings Before The FERC.* Ohio Power filed rate increases for its wholesale service to petitioners on May 28, 1982. Pet. App. 32a. The FERC initiated a rate proceeding pursuant to Sections 205 and 206 of the FPA. After all other issues had been settled, the only remaining issue was the reasonableness of the captive coal costs Ohio Power sought to recover from its customers.

Acting under its mandate under Section 206 of the FPA to protect ratepayers from excessive charges, the FERC disallowed the portion of Ohio Power's coal costs that did not satisfy the FERC's "comparable market test." See *Public Serv. Co. of New Mexico*, 17 FERC ¶ 61,123 (1981), *aff'd sub nom. Public Serv. Co. of New Mexico* v. *FERC*, 832 F.2d 1201 (10th Cir. 1987). Under that test, utilities that purchase coal from affiliates may "recover no more from their rate-payers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier." 17 FERC at 61,246. The FERC adopted the comparable market test for two reasons: First, in the FERC's judgment, "a market-price limitation on fuel expense recovery from affiliated suppliers provides the best incentive for utilities to develop the least costly sources

of fuel." Pet. App. 42a. Second, that limitation protects consumers from the risk of "self-dealing" and "rate manipulation" that "arise[] in transactions between affiliates." *Id.* at 42a-43a.

The FERC found that Ohio Power had paid to its captive coal subsidiary approximately 50 percent more than the market price in 1980, approximately 94 percent more than the market price in 1981, and approximately 24 to 33 percent more during the period from 1982 to 1986. Pet. App. 44a-45a, 58a-59a & n.87. Accordingly, the FERC ordered Ohio Power to establish rates calculated to recover from its customers no more than the comparable market price. Pet. App. 65a-67a. The FERC also ordered Ohio Power to refund prior illegal overcharges of approximately $10 million to its wholesale customers, which those customers may be required to repay if the decision below is affirmed. See Pet. App. 66a; Ohio Power Co., Revised Compliance Filing, Docket No. ER82-553-004 (FERC Apr. 24, 1989).

Ohio Power contended that, under Section 318, the FERC has no jurisdiction over the coal charges Ohio Power passes on to its customers. Ohio Power argued it is required by Section 13(b) of PUHCA and SEC orders to pay to SOCCO the "costs" of producing coal from SOCCO's mine, including salaries and a return on investment, regardless of whether those costs were above comparable market prices. Ohio Power further argued that the SEC's regulation of the "subject matter" of coal contracts ousts the FERC of all jurisdiction to regulate the coal charges embodied in Ohio Power's wholesale electric rates.

The FERC rejected this interpretation of Section 318. The FERC found that Section 318 ousts it of jurisdiction over a particular subject matter only if a requirement imposed under PUHCA actually conflicts with a requirement imposed under the FPA. Pet. App. 34a-37a. The FERC concluded that, based upon its analysis of the relevant SEC rules and orders, "it appears . . .

the SEC [does] not require a cost-based price for the subsidiary coal." Pet. App. 37a. Indeed, the FERC also noted that "the SEC may require a market-based price for subsidiary coal if the market price is lower than cost." Pet. App. 37a.[3] The FERC therefore concluded that there was "no conflict in the regulation by the SEC and the regulation by this Commission" and hence, that Section 318 did not apply. Pet. App. 37a-38a.

4. *The Court Of Appeals' Decision.* A divided court of appeals reversed. The court did not dispute the FERC's conclusion that its comparable market test is necessary to protect consumers against self-dealing and rate manipulation arising from inter-affiliate transactions. Nor did the court dispute the FERC's findings that, during each year from 1981 to 1986, Ohio Power paid its captive coal subsidiary between 24 percent and 94 percent more than comparable market prices, and that Ohio Power had passed those inflated costs on to its customers. Nor did the court dispute the FERC's determination that the SEC does not regulate the fuel charges that are passed on to customers of a public utility subject to PUHCA, and that there is therefore no actual conflict between the SEC's exercise of its jurisdiction under PUHCA and the FERC's exercise of jurisdiction under the FPA. Instead, the panel majority agreed with Ohio Power that Section 318 completely deprives the FERC of its authority to regulate the fuel charges that a public utility purchasing fuel from an affiliated company may pass along to consumers in wholesale rates.

[3] Alternatively, the FERC observed that the SEC does not regulate rates, as the SEC itself has repeatedly acknowledged. Pet. App. 37a-40a. Accordingly, the FERC held that for purposes of Section 318 the relevant "subject matter" of SEC regulation under PUHCA in this case was the transfer price of coal between SOCCO and Ohio Power, not the "fuel costs Ohio Power may collect from its wholesale customers." Pet. App. 37a. According to the FERC, "setting the intra-corporate price and setting rates are not the same subject matter which would bring section 318 into play." *Id.*

In reaching that conclusion, the majority first held that the FERC is not entitled to any deference in its interpretation of Section 318 of the Federal Power Act. The majority acknowledged that *Chevron, USA, Inc.* v. *NRDC*, 467 U.S. 837 (1984), and other decisions of this Court require a reviewing court to defer to " 'an agency's construction of the statute which it administers.' " Pet. App. 8a (quoting *Chevron*, *supra*, 467 U.S. at 842). The majority held, however, that "Section 318 cannot be said to be entrusted to the FERC's administration" because that provision "involves" the FERC "only to the extent of FERC's interface with regulation of the regulated entities by the SEC under PUHCA." Pet. App. 8a. Therefore, according to the majority, the rule requiring deference to an agency's statutory interpretation does not apply.

Interpreting the statute *de novo*, the court rejected the FERC's interpretation of Section 318. The court of appeals held that the FERC's interpretation "proceeds from a false premise that the bar of section 318 applies only where there is a present conflict between SEC and FERC prescriptions." Pet. App. 14a. According to the court, Section 318 "bars FERC jurisdiction whenever a person is 'subject . . . to a requirement' " imposed under PUHCA. *Id.* Because Ohio Power is "subject to Section 13(b) with respect to its contractual relations with SOCCO," it is irrelevant whether any conflict exists between requirements imposed under the two statutory schemes. *Id.* According to the court, "[i]t is sufficient for present purposes that the SEC is charged by the statute with regulating the terms of affiliate contracts." Pet. App. 11a.[4]

Judge Mikva dissented from this part of the majority's opinion. He would have held that Section 318 does not grant the SEC exclusive jurisdiction over all costs aris-

[4] The court also rejected the FERC's interpretation of the phrase "subject matter" in Section 318. Pet. App. 9a-10a.

ing from a PUHCA-regulated contract. Instead, Section 318 grants the SEC paramount authority in the event there is an actual regulatory "conflict" between an SEC requirement and any action taken by the FERC. Pet. App. 19a-20a. Judge Mikva also observed that the SEC orders and regulations merely established a ceiling price, and that the FERC's decision not to allow all of SOCCO's "costs" to be passed on to customers merely requires Ohio Power to pass on an amount below the specified ceiling. Pet. App. 21a-23a. Thus, Ohio Power could comply with both requirements, and thereby fulfill the purposes of both statutes. Accordingly, Judge Mikva concluded that there was no conflict in the requirements imposed upon Ohio Power that would warrant depriving the FERC of its ratemaking authority. Pet. App. 23a.[5]

The court of appeals denied rehearing. Pet. App. 29a. Judge Mikva issued a statement urging rehearing because "the panel opinion creates a regulatory gap that can be mischievous in future cases" in "this important and delicate area of inter-agency administration of the law." Pet. App. 30a. As Judge Mikva explained, "[t]he statutory interpretation engaged in by the majority . . . generates a no-man's land where neither the [SEC] nor FERC will patrol holding company practices which can oppress consumers, investors and the public." *Id.*

This Court granted certiorari on March 26, 1990.

[5] Judge Mikva ultimately concurred in the decision to set aside the FERC's order. In his view, a FERC rule, 18 C.F.R. § 35.14(a)(7), requires the FERC to accept for ratemaking purposes fuel prices that are subject to the jurisdiction of the SEC. That rule provides that such costs "shall be deemed to be reasonable" for ratemaking purposes. 18 C.F.R. § 35.14(a)(7) (1989). In its decision, the FERC had held that this language merely "creates a *presumption* of reasonableness, not a conclusive finding of reasonableness" Pet. App. 41a (emphasis added). Judge Mikva, however, disagreed with the FERC's interpretation of its regulation, and held that the regulation's language creates a conclusive presumption. Pet. App. 27a-28a. The majority expressed no opinion on this issue.

SUMMARY OF ARGUMENT

1. On its face, the Public Utility Act grants regulatory authority to *both* the SEC and the FERC over a number of matters affecting public utilities owned by holding companies, including inter-affiliate contracts. The core question in this case—the meaning of Section 318 of the FPA—turns on whether Congress granted the SEC exclusive jurisdiction over those matters or, alternatively, whether it granted concurrent authority to the SEC and the FERC *except* when the exercise of their respective authority creates an actual conflict by imposing inconsistent obligations on a regulated utility.

Contrary to the court of appeals' reading, the language of Section 318 demonstrates Congress' intent to create a scheme of concurrent, rather than exclusive, federal regulatory authority. Section 318, which is entitled "*Conflict* of jurisdiction," ousts the FERC of jurisdiction only when the same "person" is subject to "requirements" imposed under both PUHCA and the FPA "with respect to the same subject matter." Section 318 therefore stands in marked contrast to Section 204(f) of the FPA, which exempts from the FERC's authority over securities issues "a public utility organized and operating in a State under the laws of which its securities issues are *regulated by* a State Commission." 16 U.S.C. § 824c(f) (emphasis added). If Congress had intended to make SEC regulation exclusive whenever it overlaps with jurisdiction conferred on the FERC, Congress plainly knew how to do so and would have used language similar to Section 204(f). The court of appeals' interpretation, moreover, reads the term "requirement" out of Section 318. That interpretation was also rejected by this Court's decision in *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119, 122 (1944), which upheld accounting regulations of the FPC because "no conflict exist[ed]" with PUHCA or with SEC orders.

The legislative history confirms this plain meaning. The Senate report on Section 318, for example, stated

that "in the case of *conflict* between the provisions of the Federal Power Act and [PUHCA], the *requirements* of the latter act shall apply. . . ." S. Rep. No. 621, 74th Cong., 1st Sess. 54 (1935) (emphasis added).

The structure of the Public Utility Act also points decisively to a system of dual, complementary regulation that is fundamentally inconsistent with the court of appeals' vision of exclusive SEC authority. That Act "had two primary and related purposes," corresponding to the regulatory responsibilities of two separate federal agencies: "to curb abusive practices of public utility companies by bringing them under effective control [of the SEC], and to provide effective federal regulation [by the FERC] of the expanding business of transmitting and selling electric power in interstate commerce." *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 758 (1973). Consistent with this scheme, Congress specifically considered and rejected a proposal that would have required the SEC to act as a ratemaking body with respect to contracts between affiliated companies. See 79 Cong. Rec. 10,838 (1935); H.R. Conf. Rep. 1903, 74th Cong., 1st Sess. 72 (1935).

Moreover, because the responsibility—and the tools—for ratemaking review were lodged with the FERC rather than the SEC, the court of appeals' interpretation of Section 318 creates a severe gap in the comprehensive federal regulatory scheme Congress created. Granting the SEC exclusive jurisdiction over the "subject matters" enumerated in Section 318 deprives the FERC of any ability to regulate accounting methods and reports that are essential to its ratemaking responsibilities, or to have any say in such matters as sales of utility assets. That interpretation also effectively eliminates any FERC review of the costs incurred in connection with an inter-affiliate contract to determine whether they are "just and reasonable."

2. Even if Congress' intent were not clear, the court of appeals should have deferred to the FERC's interpretation that Section 318 requires an actual conflict. When Congress' intent is not clear, this Court's decisions require an agency's interpretation of its own organic statute to be accepted by the courts as long as that interpretation is "reasonable." *E.g.*, *Chevron, USA, Inc.* v. *NRDC*, 467 U.S. 837, 845 (1984). Because it is part of a statute (the Federal Power Act) administered by the FERC, Section 318 falls squarely within that rule. The fact that Section 318 deals with the FERC's own authority does not undermine the rationale for judicial deference. Indeed, this Court has applied the *Chevron* rule to other jurisdictional provisions. *E.g.*, *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833 (1986). Similarly, it is immaterial that Section 318 implicates the authority of the SEC as well as that of the FERC, because in this case both agencies agree that Section 318 requires an actual conflict.

3. No actual conflict exists here for at least two independent reasons. First, as the FERC itself concluded, nothing in PUHCA, the SEC regulations, or the relevant orders *requires* Ohio Power to pay to SOCCO the actual costs of SOCCO's coal. Indeed, nothing in those provisions requires Ohio Power to take any coal from SOCCO at all. On their face, moreover, the SEC's regulations merely establish an upper limit on the price SOCCO may charge. It would be absurd to interpret PUHCA or the SEC regulations to prevent Ohio Power from paying *less* than the "costs" incurred by Ohio Power's wholly-owned subsidiary, particularly when those "costs" are substantially above the market price.

Second, even if something in PUHCA or in the SEC's regulations or orders could be construed to require Ohio Power to take coal from SOCCO, and to pay to SOCCO an amount equal to SOCCO's "costs," that requirement is not in "actual conflict" with the FERC's determi-

nation that the full amount of those "costs" cannot be passed on to Ohio Power's customers. Ohio Power, in short, can absorb the difference. Compliance with both requirements will reduce Ohio Power's profits, but it is not "a physical impossibility." *Pacific Gas & Elec. Co.* v. *State Energy Resources Conservation and Dev. Comm'n*, 461 U.S. 190, 204 (1983).

4. Finally, the court of appeals' decision cannot be affirmed on the alternative ground that Section 35.14(a)(7) of the FERC's own regulations prohibits the FERC from imposing market-price restrictions on wholesale rates. The FERC's interpretation of its own regulation is entitled to the highest deference and must be accepted by a reviewing court as long as it is reasonable. *E.g., Jewett* v. *Commissioner*, 455 U.S. 305, 318 (1982); *Udall v. Tallman*, 380 U.S. 1, 16-17 (1965). The FERC's interpretation of its regulation, as creating a rebuttable, rather than a conclusive, presumption, easily satisfies that requirement. *E.g., Lavine* v. *Milne*, 424 U.S. 577 (1976).

ARGUMENT

In *Chevron, USA, Inc.* v. *NRDC*, 467 U.S. 837 (1984), this Court articulated the now-familiar framework for judicial review of an agency decision interpreting its organic statute. First, the court determines whether "Congress has directly spoken to the precise question at issue." *Id.* at 842. If Congress' intent is not clear, the court then determines whether the agency's interpretation is reasonable. If it is, the court defers to that interpretation. *Id.* at 843.

Congress' intent in enacting Section 318 is clear: It does not oust the FERC of its ratemaking authority unless an actual conflict exists between requirements imposed by the FERC and the SEC. Even if Congress' intent were less clear than it is, however, the FERC's interpretation of Section 318 is eminently reasonable. Accordingly, the holding below must be reversed because

there is no actual conflict between the FERC's application of its "comparable market" rule and any requirement imposed under PUHCA. Finally, the FERC's decision to set aside the coal charges as unjust and unreasonable did not violate Section 35.14(a)(7) of its own regulations.

I. CONGRESS CLEARLY DID NOT INTEND TO PREVENT THE FERC FROM REGULATING INTERSTATE WHOLESALE ELECTRIC RATES ABSENT AN ACTUAL CONFLICT WITH A REQUIREMENT OF *PUHCA* OR THE SEC.

In the Public Utility Act of 1935, Congress created a comprehensive scheme of federal regulation of public utility holding companies and the interstate operations of their utility operating subsidiaries. Congress implemented that scheme by granting to the SEC the primary responsibility for regulating holding companies pursuant to Title I of the Public Utility Act, PUHCA, and granting to the FERC the primary responsibility for regulating their operating subsidiaries under Title II, the FPA. Because of the abuses associated with both utilities and their holding companies, Congress granted the FERC and the SEC concurrent and complementary jurisdiction over a number of regulatory matters. Recognizing the possibility of conflicts between the two agencies, Congress included Section 318 of the FPA, the "conflict of jurisdiction" provision that is principally at issue in this case.

Contrary to the court of appeals' interpretation, Section 318 deprives the FERC of its ratemaking authority over a particular matter only in the event of an actual conflict between requirements imposed of or under the FPA and of or under PUHCA. This conclusion is demonstrated by the plain language of Section 318. It is confirmed by the legislative history of that provision as well as the structure of the Public Utility Act. In short, this is a case in which Congress has "directly spoken

to the precise question at issue." *Chevron*, *supra*, 467 U.S. at 842.

A. The Language Of Section 318 Plainly Indicates A Congressional Intent To Permit The FERC To Regulate Concurrently With The SEC Absent An Actual Conflict Between Requirements Of The SEC And The FERC.

"The starting point for . . . interpretation of a statute is always its language." *Community For Creative Non-Violence* v. *Reid*, 109 S.Ct. 2166, 2172 (1989); see *Dole* v. *United Steelworkers of America*, 110 S.Ct. 929, 934 (1990). The plain language of Section 318 deprives the FERC of authority *only* if (1) the *same* "person" is (2) "subject *both* to a *requirement*" imposed under PUHCA "*and* to a *requirement*" imposed under the FPA (3) with respect to the *same* "subject matter." 16 U.S.C. § 825q (emphasis added). The fact that the same person must be subject to two different "requirements" with respect to the same "subject matter" obviously assumes that the two requirements are in direct conflict. Otherwise, there would be no need to speak of "requirements," as opposed, for example, to "provisions" of the relevant statutes. Any possible doubt about whether the two "requirements" must conflict is removed by the heading of the section, enacted with the original legislation: "Conflict of Jurisdiction."[6]

The precise interpretation placed on Section 318 by the court of appeals is far from clear. There are indications that the court viewed Section 318 as creating exclusive jurisdiction in the SEC over all matters within its

[6] "Where headings are enacted as part of an act, . . . the headings may serve as an aid to the legislative intent." 2A *Sutherland Statutory Construction* § 47.14 (4th ed. 1984). This general rule is firmly grounded in decisions of this Court. *E.g.*, *Maguire* v. *Commissioner*, 313 U.S. 1, 9 (1941); *Knowlton* v. *Moore*, 178 U.S. 41, 65 (1900) (rejecting an interpretation of a federal statute as "rebutted by the heading"); see also *Hardin* v. *City Title & Escrow Co.*, 797 F.2d 1037, 1039 (D.C. Cir. 1986).

authority, regardless of whether the SEC exercised that authority by imposing any specific "requirements." See, *e.g.*, Pet. App. 11a. On the other hand, the court's opinion can be read, more narrowly, as granting exclusive jurisdiction to the SEC only when the SEC has actually exercised some authority over the "subject matter" at issue. See Pet. App. 14a. Both of these expansive interpretations of Section 318 violate at least two well-established principles of statutory construction.

First, they violate the principle that different words in the same statute should not be interpreted to have the same meaning. *E.g.*, *Russello* v. *United States*, 464 U.S. 16, 23 (1983); *United Savings Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988). Section 318 stands in marked contrast to Section 204(f) of the FPA, which serves a similar jurisdiction-allocating function but uses significantly different language. Section 204(f) exempts from the securities regulation scheme of Section 204 "a public utility organized and operating in a State under the laws of which its security issues are *regulated by* a State Commission." 16 U.S.C. § 824c(f) (emphasis added). In so doing, it makes state authority exclusive, not automatically, but only when a state chooses to exercise its jurisdiction by actually regulating the securities issues of a particular company.

The court of appeals interpreted Section 318 as though it ousts the FERC of jurisdiction whenever a particular "subject matter" is either "regulated" or subject to regulation by the SEC. Had Congress intended to grant the SEC such exclusive jurisdiction, it would have used one of those formulations—or some similar formulation such as "subject to the jurisdiction of the SEC."

Second, the court of appeals' reading of Section 318 violates the well-established principle that statutes should be interpreted to give meaning to every word and phrase, *i.e.*, to avoid rendering any provision redundant. See, *e.g.*, *Mountain States Tel. & Tel. Co.* v. *Pueblo of Santa Ana*,

472 U.S. 237, 249 (1985); *United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955). Section 318 specifies that a person must be "subject . . . to a requirement of [PUHCA] or of a rule, regulation or order thereunder," and to "a requirement of the [FPA] or of a rule, regulation or order thereunder" with respect to the same subject matter. But the court of appeals simply read "a requirement of" out of the statute. The only way to give meaning to that phrase is to read Section 318 as the FERC did, *i.e.*, as requiring an actual conflict.

Moreover, both readings of the court of appeals' opinion are irreconcilable with *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944), in which this Court held that a conflict is required to invoke Section 318. *Id.* at 125. In that case, petitioner argued that because SEC accounting requirements and FPC accounting requirements covered "the same field," Section 318 ousted the FPC of jurisdiction. Pet. Reply Br. at 25, *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944). The court rejected that argument and held that "an examination of the statute and of the orders and proceedings of the Securities and Exchange Commission satisfies us that *no conflict exists*." *Id.* (emphasis added); see *Appalachian Power Co.* v. *FPC*, 328 F.2d 237, 250 (4th Cir.) ("Under section 318 of the Federal Power Act *actual conflicts* between the FPC and the SEC are resolved in favor of the SEC"), *cert. denied*, 379 U.S. 829 (1964) (emphasis added). Thus, this Court has already rejected the argument that the SEC and the FERC may not operate in the same regulatory field.

B. The Legislative History Of The Public Utility Act Confirms That Congress Intended Section 318 To Apply Only In Cases Of Actual Conflict Between Requirements Imposed By The SEC And The FERC.

The legislative history of Section 318 is significant in two respects. First, it directly confirms Congress' intent that Section 318 apply only in cases of genuine conflict. Second, it reveals that Congress well understood how to distinguish, in the language it selected, between a scheme of exclusive jurisdiction and a scheme of complementary, concurrent regulation.

1. Congress' intent that Section 318 would apply only in cases of actual conflict is demonstrated repeatedly by the legislative history. In 1934, President Roosevelt and congressional leaders requested the FPC to draft legislation to regulate electric utilities engaged in interstate commerce for the purpose of ensuring reasonable rates to consumers. DeVane, *Highlights of Legislative History of the Federal Power Act of 1935 and the Natural Gas Act of 1938*, 14 Geo. Wash. L. Rev. 30, 34 (1945) (account by former FPC solicitor and principal drafter of FPA). Meanwhile, the presidentially appointed National Power Policies Committee was drafting legislation to regulate holding companies. *Id.* at 37. Once the bills were drafted, congressional leaders decided that they should be introduced as a single package. The task of consolidating the two bills was delegated to yet another administration drafting committee:

> When it became obvious that the task assigned the committee could not be accomplished in the time allotted, those in charge of the drafting of the two bills got together and agreed upon the substance of an amendment to the Holding Company Bill, later incorporated in Section 3 of that Bill, (which was intended to provide for full cooperation between the Securities and Exchange Commission and the Federal Power Commission in administering the two acts) and to Section 318 of the Federal Power Bill . . .. resolving *conflicts* in favor of the Holding Company Act.

Id. at 37-38 (emphasis added). See Welch, *Functions of the Federal Power Commission in Relation to the Securities and Exchange Commission*, 14 Geo. Wash. L. Rev. 81, 82-83 (1945) (emphasis added).

Thus, the drafters of Section 318 recognized that PUHCA and the FPA granted concurrent authority to the SEC and the FPC over a number of subject areas. They did not, however, attempt to reconcile potential conflicts by granting exclusive jurisdiction to either agency. Instead, they expected that the two agencies would give each other "full cooperation" in administering their respective regulatory schemes, with actual "conflicts" between SEC and FPC requirements resolved in favor of the SEC.[7]

All of the legislative reports confirm the conclusion that Section 318 comes into play only in the event of conflicting requirements. For example, the Senate Committee on Interstate Commerce observed that "in case of *conflict* between the provisions of the Federal Power Act and [PUHCA], the requirements of the latter act shall apply, unless the person subject to such requirement has been exempted by the [SEC]." S. Rep. No. 621 at 54 (1935) (emphasis added); see also H.R. Rep. No. 1318, 74th Cong., 1st Sess. 35 (1935) (same); H.R. Conf. Rep. No. 1903 at 75 (Section 318 resolves "conflicts" between the SEC and FPC in favor of the former). That description of Section 318 is impossible to reconcile with the court of appeals' view that SEC authority is exclusive as to any "subject matter" that it regulates or is authorized to regulate in any way.[8]

[7] Similarly, the FPC explained to both the House and the Senate Committees that Section 318 "provides that in case of *conflict* between the provisions of the Federal Power Act and the Holding Company Act of 1935 the requirements under the latter act shall apply." *Public Utility Holding Companies: Hearings on H.R. 5423 Before the House Comm. on Interstate and Foreign Commerce*, 74th Cong., 1st Sess. 388 (1935) ("*House Hearings*") (emphasis added); *Public Utility Holding Company Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce*, 74th Cong., 1st Sess. 249 (1935) ("*Senate Hearings*") (same).

[8] As passed by both the House and Senate, Section 318 was limited to the list of subjects enumerated in that provision, *i.e.*, "the issue, sale, or guaranty of a security, the method of keeping accounts, the filing of reports or the acquisition or disposition of any security, capital assets, or facilities. . . ." It omitted the catch-all phase "or any other subject matter." S. 2796, 74th Cong., 1st Sess. § 316(a) (1935). Each of the enumerated subjects was an area over which both the SEC and the FERC had concurrent jurisdiction. See *infra* p. 30. The phrase "or any other subject matter" was added in conference. Its purpose was merely to ensure that *any* conflict between requirements imposed by the SEC and the FERC could be resolved. See H.R. Conf. Rep. No. 1903 at 75.

2. Congress' treatment of proposed amendments further confirms this conclusion. During the Senate debate, Senator Tydings proposed to add to PUHCA a section providing that if "any person is *subject to the law* of any State, *or regulation* by a State commission, such person shall not be subject to the requirements of [the Act] or of any rule, regulation, or order thereunder, with respect to the same subject matter." 79 Cong. Rec. 8399 (1935) (emphasis added). In contrast to the "requirement" language of Section 318, this provision would have expressly divested the federal agency of jurisdiction over a holding company under PUHCA if the holding company is "subject to the law of . . . or regulation by" any State. Senator Wheeler, Chairman of the Committee on Interstate and Foreign Commerce and sponsor of the Senate bill, opposed the amendment. He observed that it "is so broadly drawn that as a matter of fact it would completely exempt practically all the subsidiary or holding companies in some States." *Id.* The Senate rejected the amendment.

Nine days later, Senator Wheeler accepted an amendment (later deleted in conference) designed to preserve the concurrent jurisdiction of federal and state regulators. Among other things, the new amendment provided that if "any person subject to a *requirement* of [PUHCA] is also subject to a *requirement*" of a state statute or of a state commission, the federal requirement would not "impair the power or rights" of the state. 79 Cong. Rec. 8859 (1935). The Senate's adoption of this amendment,

which is similar to Section 318, after rejecting the previous version reveals its understanding that the two versions had materially different meanings.

The House of Representatives also adopted an amendment to Section 318 providing that if any person was "*subject to the law* of any State *or regulation* by a State commission, such person shall not be subject to the requirements of" the FPA or any orders thereunder. 79 Cong. Rec. 10,574 (1935). After the House passed the FPA with this amendment, the FPC objected:

> The effect of this amendment is to take from the Federal Power Commission much of the jurisdiction conferred upon it in other sections of the bill, and no doubt the contention will be made that it takes from the Commission all jurisdiction except over those utilities operating in States where there are no State commissions. This amendment makes all of title II . . . substantially unworkable.

79 Cong. Rec. 10,839 (1935).[9] Congress heeded the advice of the FPC and rejected this amendment in conference, preserving the FPC's broad ratemaking and regulatory powers.

As previously shown (*supra* p. 11), the court of appeals interpreted Section 318 as though it divested the FERC of its authority whenever a public utility is "subject to" any SEC regulation (or any authority to regulate, even if unexercised), rather than merely resolving conflicts between specific "requirements" imposed by both agencies. That interpretation is fundamentally at odds with Congress' own understanding of the lan-

[9] The floor manager of the FPA also strenuously objected to the adoption of this amendment, concluding that

> It would largely destroy the usefulness of the Federal regulation this bill gives to the Federal Power Commission. We cannot have effective regulation unless we give that Commission the power to get information and give it control over accounts and valuations.

79 Cong. Rec. 10,574 (statement of Rep. Lea).

guage used in Section 318. Like the amendments rejected by Congress, moreover, it makes the FPA "substantially unworkable."

C. The Court Of Appeals' Decision Is Inconsistent With The Structure Of The Public Utility Act Because It Creates Significant Gaps In The Comprehensive Regulatory Scheme Created By That Act.

Even if the language and legislative history of Section 318 were not dispositive, the structure of the Public Utility Act supports the FERC's interpretation that Section 318 applies only when there is an actual conflict between an SEC requirement and a FERC requirement. Compare, *e.g.*, *Crandon* v. *United States*, 110 S.Ct. 997, 1001 (1990); *K Mart Corp.* v. *Cartier, Inc.*, 108 S.Ct. 1811, 1817 (1988). The court of appeals' view—that the SEC has exclusive authority over any regulatory field in which it operates—is contradicted by Congress' evident intent to create dual, complementary regulatory regimes. The court of appeals' interpretation also creates enormous regulatory gaps that Congress plainly did not intend.

1. The two titles of the Public Utility Act—PUHCA and the FPA—were plainly designed to create complementary regulatory regimes. This is established by three features of the statutory scheme.

First, the FPA and PUHCA were enacted to fill two different gaps in the regulation of electric utilities by state regulatory agencies. See *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 758 (1973). One gap arose when local operating companies, previously subjected to state regulation in their intrastate operations, began to transmit and sell electricity at wholesale in interstate commerce. At about the same time, this Court held in *Public Utilities Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927), that states were prohibited from regulating interstate wholesale rates of electric utilities.

Congress recognized that *Attleboro* resulted in a substantial void in the state-by-state regulatory scheme. S. Rep. No. 621 at 17; H.R. Rep. No. 1318 at 7-8. Accordingly, "the main purpose of [the FPA] was to 'fill the gap' created by *Attleboro* and its predecessors." *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Serv. Comm'n*, 461 U.S. 375, 379 (1983).

The other gap resulted from the inability of state utility commissions "to reach and effectively control the local utility business when it was dominated and controlled by a holding company located in a far-off city." 79 Cong. Rec. 8773 (1935) (Sen. Wheeler). See PUHCA § 1(a), 15 U.S.C. § 79a(a) (holding company "activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies"). PUHCA itself states that its purpose was "to meet the problems and eliminate the evils . . . connected with public-utility holding companies." PUHCA § 1(c), 15 U.S.C. § 79a(c).[10]

Second, and consistent with the differing purposes of the two regulatory regimes, Congress gave the FPC and the SEC substantially different responsibilities and objectives. The FPC was empowered to regulate the "operating functions" of public utilities, including the operating subsidiaries of holding companies. S. Rep. No. 621 at 4; see also 79 Cong. Rec. 10,564 (1935) (Rep. Wadsworth). Its principal objective was to ensure that all "rate[s], charge[s] [and] classification[s]," as well as "any rule, regulation, practice, or contract affecting such rate, charge, or classification" were "just and reasonable." FPA § 206(a), 16 U.S.C. § 824e(a). Its mission was to foster the production of "an abundance of electricity at the lowest possible cost." S. Rep. No. 621 at 17.

[10] Section 1 of PUHCA listed five specific "evils" connected with public utility holding companies: (1) insufficient information about and regulation of a holding company's securities (PUHCA § 1(b)(1), 15 U.S.C. § 79a(b)(1)); (2) excessive charges made to operating public utilities for goods or services provided through inter-affiliate contracts (PUHCA § 1(b)(2), 15 U.S.C. 79a(b)(2)); (3) control of an operating utility's accounting practices so as to thwart state regulation (PUHCA § 1(b)(3), 15 U.S.C. § 79a(b)(3)); (4) undue growth of holding companies (PUHCA § 1(b)(4), 15 U.S.C. § 79a(b)(4)); and (5) inadequate service or inadequate public regulation (PUHCA § 1(b)(5), 15 U.S.C. § 79a(b)(5)). Noticeably absent from this list is any mention of excessive interstate wholesale rates, which Congress obviously believed would be fully regulated under the FPA.

The SEC, by contrast, was given no responsibility over rates or any other "operating functions" of public utilities. The Senate Committee explained the difference:

> [T]itle [I] is concerned only with holding companies in the public-utility field, defined for the purposes of the title as companies which "control" operating public-utility companies. Title I does not eliminate any operating utility company or *regulate it in any of its operating functions.*

S. Rep. No. 621 at 4 (emphasis added). See also 79 Cong. Rec. 10,564 (1935) (Rep. Wadsworth) ("The Securities Exchange Commission has charge of the regulation of registered holding companies and not of the operating companies engaged in interstate transportation of electrical energy"). Thus, although the SEC was given "jurisdiction" over all of the subsidiaries, including the operating subsidiaries, of any holding company (see generally PUHCA § 2(a), 15 U.S.C. § 79b(a)), its statutory mandate was to implement a regulatory scheme designed to "eliminate the evils . . . connected with public-utility holding companies" (PUHCA § 1(c), 15 U.S.C. § 79a(c)), not to regulate their utility operations.[11] Un-

[11] While Congress ultimately agreed, after seriously considering abolishing public utility holding companies, to permit the continuation of certain holding companies as long as they restructured their operations, one of the primary purposes of PUHCA was "to provide as soon as practicable for the elimination of public-utility

like the FPC, moreover, the SEC was given express statutory responsibility to regulate for the protection of investors as well as consumers. *E.g.*, PUHCA §§ 6(b), 7(a), 13(b).

Third, the SEC and the FERC were given substantially different tools with which to accomplish their missions. The FERC's most important tool is its authority to determine whether a rate, including the impact of any contract or other practice that affects that rate, is "just and reasonable." As this Court has frequently recognized, the "just and reasonable" standard gives the FERC wide discretion in the setting of rates and charges. *E.g.*, *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 600 (1944); *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 291 (1974). This is the same broad authority long associated with economic rate regulation. By specifying that rates must be "just and reasonable," Congress was fully aware that it was giving the FERC a powerful regulatory weapon.

Congress also gave the FERC a number of other important powers incident to its ratemaking responsibilities. Section 208 authorized the FERC to "ascertain the actual *legitimate* cost of [utility] properly." 16 U.S.C. § 824g(a) (emphasis added). This, of course, authorizes the FERC to look behind cost data provided by regulated utilities to determine whether any costs incurred are prudent. The FPA also provided the procedural mechanisms necessary to regulate electric rates: complaint procedures (FPA § 306, 16 U.S.C. § 825e); investigative procedures (FPA § 307, 16 U.S.C. § 825f); hearing procedures (FPA § 308, 16 U.S.C. § 825g); and, perhaps most important, the ability to order refunds if a utility is found

holding companies except as otherwise expressly provided in [PUHCA]." PUHCA § 1(c), 15 U.S.C. § 79a(c). Compare S. 2796, 74th Cong., 1st Sess. § 11 (1935) with FPA § 201(a), 16 U.S.C. § 824(a).

to have violated the "just and reasonable" standard (FPA § 205(e), 16 U.S.C. § 824d(e)).

The SEC, by contrast, was given extensive authority to regulate financial transactions by or within public utility holding companies. See, *e.g.*, PUHCA §§ 7, 10, 13(b), 15. But it was not expressly granted any of the ratemaking and related powers given to the FERC. To be sure, Section 13(b) permits the SEC to reject an inter-affiliate contract if the goods or services to be provided thereunder are not provided "at cost, fairly and equitably allocated among [affiliated] companies," as defined by SEC rule or order. 15 U.S.C. § 79m(b). But the SEC does not have express authority to reject any contract or other practice of a public utility solely because, in the SEC's view, it is not "just and reasonable." Similarly, PUHCA provides no procedures by which a customer can initiate a complaint, no procedures for investigating or holding hearings with respect to rates, and no mechanism for ordering refunds to customers.

Indeed, Congress, at the SEC's urging, expressly rejected a proposal that would have granted limited ratemaking powers to the SEC under what is now Section 13(b) of the PUHCA. The House bill required the SEC to act as a quasi-ratemaking body with respect to affiliate contracts, setting, *inter alia*, a contract price that it deemed "necessary or appropriate in the public interest or for the protection of investors or consumers." H.R. 5423, 74th Cong., 1st Sess. § 13 (1935). The Senate bill, on the other hand, required only that such contracts be performed "at cost fairly and equitably allocated among [the affiliated] companies." S. 2796, 74th Cong., 1st Sess. § 13 (1935). After passage of both bills, but before they were referred to a conference committee, the chairman of the SEC balked at granting his agency this broad authority:

> It is also my opinion that from an administrative point of view section 13 of the House bill is open to

> serious objection. The comparable section in the Senate bill was very definite and explicit to the effect that intrasystem service transactions should be on a cost or mutual basis. The administration of such a law involves no great burden.
>
> The language of section 13 (of the House bill) seems to indicate that our Commission is required to pass on . . . intercompany service contracts to determine whether their terms are fair and involve no unreasonable profit. It appears to me that this task which will devolve upon the Commission will be an impossible one.

Letter from Joseph P. Kennedy, Chairman, SEC to Senator Wheeler (July 9, 1935), *reprinted in* 79 Cong. Rec. 10,838. Congress agreed with the SEC. It granted the SEC the limited authority contained in current Section 13 (see H.R. Conf. Rep. 1903 at 72), reserving to the FERC the more difficult task of determining "just and reasonable" rates and charges, including, in Chairman Kennedy's words, whether the terms of inter-company service contracts "involve no unreasonable profit."

To be sure, both agencies were also given some authority over the four "subject matters" specifically identified in Section 318: (1) "the issue, sale, or guaranty of a security" (see FPA § 204, 16 U.S.C. § 824c; PUHCA §§ 6, 12, 15 U.S.C. §§ 79f, 79l); (2) "the method of keeping accounts" (see FPA § 301, 16 U.S.C. § 825(c); PUHCA § 14, 15 U.S.C. § 79n); (3) "the filing of reports" (FPA § 304, 16 U.S.C. §825c; PUHCA § 14, 15 U.S.C. § 79n); and (4) "the acquisition or disposition of any security, capital assets, or facilities" (FPA § 203, 16 U.S.C. § 824b; PUHCA §§ 9, 10, 15 U.S.C. §§ 79i, 79j). Both agencies were also given authority over interlocking directorates (see FPA § 305, 16 U.S.C. § 825d; PUHCA § 17, 15 U.S.C. § 79q) and, most relevant to this case, over inter-affiliate contracts for goods and services (FPA § 206(a), 16 U.S.C. § 824e(a); PUHCA § 13(b), 15 U.S.C. § 79m(b)). But the striking

differences in the other responsibilities and powers given to the two agencies strongly indicate that, even in these areas of shared authority, Congress did not view regulation by the SEC as a substitute for regulation by the FERC.[12] Rather, SEC and FERC regulation were designed to complement one another for the ultimate benefit of both consumers and investors.

This commingling of functions for a common purpose, in turn, suggests that the two agencies would exercise concurrent authority in areas of joint responsibility as long as that did not impose inconsistent obligations on the regulated utility. To view Section 318 as vesting the

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[12] Indeed, the legislative history of PUHCA shows that Congress did not consider the SEC's jurisdiction over inter-affiliate contracts as a substitute for—or to conflict with—ratemaking review. In testimony on the House bill, Commissioner Seavey of the FPC provided the following example of the effect of affiliate contracts on rates:

> The San Diego Gas & Electric Co. is a subsidiary of the Byllesby people. They have been charging something like $170,000 yearly for their services. The California commission found that $70,000 was a reasonable cost of those services, and only allowed that much in fixing rates; but the Byllesby Co. can still draw upon that company and deplete its reserves, without [the utility] being able to take it in a rate case.

House Hearings at 407 (statement of Commissioner Seavey); see also *Senate Hearings* at 757-58 (statement of John Benton, Nat'l Assoc. of Railroad and Utility Commissioners). In response to questions from members of the Committee, Commissioner Seavey pointed out that even though the regulators limited recovery from ratepayers to the market value, the underlying contract remained valid and, because state commissions lacked authority to halt such an abuse, the holding company could continue to drain the earnings of the operating company based on the $170,000 face amount of that contract. *House Hearings* at 409. Commissioner Seavey stressed that the only authority of state commissions was to regulate the income that the operating companies received in rates, and not the expenses that those companies paid on contracts. The manifest purpose of Section 13(b) was to prevent such "bleeding" of public utility companies by the holding companies that owned them, not to limit rate-making review.

SEC with exclusive jurisdiction over these matters both distorts and undermines the dual scheme of federal regulation created by Congress.

2. As this Court has observed, "Congress' purpose in 1935 was to fill a regulatory gap, not to perpetuate one." *Arkansas Elec. Coop.*, 461 U.S. at 384. Yet, the court of appeals' interpretation of Section 318 creates several gaping holes in the regulatory structure of the Public Utility Act. If the SEC's jurisdiction were exclusive as to any "subject matter" over which it has regulatory authority (or over which it chooses to exercise such authority), then the FERC would have no authority over a number of significant regulatory problems. In short, the court of appeals "imput[ed] to Congress a purpose to paralyze with one hand what it sought to promote with the other." *American Paper Inst., Inc.* v. *American Elec. Power Serv. Co.*, 461 U.S. 402, 421 (1983).

First, under the court of appeals' decision, the FERC would have no authority to impose accounting or record-keeping requirements upon public utilities that are owned by registered holding companies, as it is plainly authorized to do by Sections 301 and 304 of the EPA (see *Northwestern Elec. Co.* v. *FPC*, 321 U.S. at 122) because the SEC has exercised its authority to impose such requirements on those same companies. See PUHCA § 15, 17 C.F.R. pt. 256 (1989). These companies represent a substantial part of the FERC's regulatory docket: They serve, directly or indirectly, approximately 49 million households and businesses in 30 states and the District of Columbia, and account for approximately 16 percent of revenues from the sale of power generated by all electric utilities.[13] Given the importance of proper accounting and reporting procedures in determining just and

[13] See Federal Energy Regulatory Commission, FERC Form 1, Annual Reports of Major Electric Utilities, Licensees and Others (1988); Electrical World, Directory of Electric Utilities (98th ed. 1990).

reasonable rates, a limitation on the FERC's authority over accounting and reporting requirements would make it virtually impossible for the FERC to carry out its vital regulatory mission. Congress could not have intended such a result. See *supra* note 9.

Second, the court of appeals' interpretation of Section 318 would likewise oust the FERC of any regulatory jurisdiction (under Sections 203 and 204 of the FPA) over major transactions—including the sale of utility assets and securities issues—involving public utilities owned by holding companies. Precluding review of these matters by the FERC would deprive consumers of any assurance that such transactions will preserve their ability to purchase electricity at "just and reasonable" rates.

Third, the court of appeals' interpretation of Section 318 also effectively eliminates *all* review of the "justness and reasonableness" of costs incurred in connection with inter-affiliate contracts. That includes not only fuel costs, but also such other operating expenses as engineering costs, legal costs, accounting costs, and communications costs. It also includes capital costs for items such as the construction of a nuclear reactor or a hydroelectric plant.[14] Under the court of appeals' decision, the FERC could not, for example, determine whether costs incurred under an inter-affiliate contract in building a nuclear reactor are prudent: it must simply accept the entire "cost" so incurred. The decision below thus makes it impossible for FERC to protect nearly 50 million ratepayers against potential self-dealing, unnecessary "gold plating" of plant and equipment, and rate manipulation arising

[14] In addition to numerous coal subsidiaries, utility holding companies also have nuclear fuel subsidiaries, fuel oil subsidiaries, real estate subsidiaries, communications subsidiaries, leasing subsidiaries, credit subsidiaries, legal, accounting and engineering service subsidiaries, construction subsidiaries, electric generation subsidiaries and assorted other subsidiary service companies. See SEC Financial and Corporate Report on Holding Companies Registered Under the Public Utility Holding Company Act of 1935 at 12-65 (Dec. 31, 1988).

from transactions between electric utilities and their affiliates. See *supra* p. 32. For that reason, it creates a perverse incentive for any holding company to force its operating utility subsidiary to purchase an ever greater share of its inputs from affiliates. It also encourages other public utilities to adopt the holding company form in order to evade regulation, contrary to Congress' clear intent in enacting PUHCA. See PUHCA § 1(b)(2), 15 U.S.C. § 79a(b)(2); note 11 *supra*.

This case well illustrates the effects of this regulatory gap on consumers. The FERC found that the prices Ohio Power paid SOCCO for coal exceeded market prices by 24 to 94 percent from 1981 to 1986. Therefore, because coal costs represent approximately half the costs of generating electricity from coal-fired generators, the rates paid by petitioners (and their residents) between 1981 and 1986 were 12 to 47 percent higher than they would have been if the coal cost component of those rates had been limited to market prices or if Ohio Power had purchased coal from another source in an arms-length transaction. Thus, the decision below will likely lead to substantial increases in the rates petitioners (and their residents) must now pay for electricity, as well as requiring petitioners to repay the substantial overcharges refunded to petitioners under the FERC's decision. Ironically, the decision below enables Ohio Power to charge rates that would unquestionably be illegal for any other electric utility, merely because it is owned by a registered holding company.

Congress did not intend to create this enormous regulatory gap. Indeed, inter-affiliate contracts for the purchase of fuel at above-market prices were specifically identified as one of seventeen "Reprehensible Practices of Holding Companies" by Congressman Rayburn, who pointed out "instances of where fuel for the operating company cost the operating company more than twice as much as it could have been had in the open market." 79 Cong. Rec. 10,317. See also S. Rep. No. 621 at 36 (inter-

affiliate contracts "one of the most abused devices of the public-utility holding company system"); see H.R. Rep. No. 1318 at 19; see also PUHCA § 1(b)(2), 15 U.S.C. § 79a(b)(2). As this case demonstrates, only the FERC has both the responsibility and the ability to ensure that costs paid by a public utility do not result in unjust and unreasonable rates. Given its obvious concern about above-market fuel contracts, Congress could not rationally have intended to preclude ratemaking review of such contracts by the FERC.

II. EVEN IF CONGRESS' INTENT WERE NOT CLEAR, THE FERC'S INTERPRETATION IS A PERMISSIBLE READING OF ITS OWN ORGANIC STATUTE.

Even if Congress' intent in enacting Section 318 were less clear than it is, the FERC's interpretation of that provision is at least reasonable, given the language, legislative history and structure of the statute. Thus, this Court should defer to the FERC's interpretation under the second step of *Chevron*. The only possible reasons not to follow that approach here are 1) that the provision is "jurisdictional" and 2) that it also implicates the SEC's authority. But the rationale for *Chevron* deference applies with equal force to both jurisdictional and nonjurisdictional provisions in an agency's organic statute. And in this case, both agencies affected by the particular provision agree on its interpretation.

1. A number of reasons have been advanced for judicial deference to an agency's reasonable interpretation of its own organic statute. First, an ambiguity in a statutory provision often reflects a congressional intent to delegate to the agency quasi-legislative authority or discretion.[15] Second, an agency's expertise—in the his-

[15] *See Investment Co. Inst.* v. *Conover*, 790 F.2d 925, 935 (D.C. Cir.) ("*Chevron* teaches that Congress may delegate interpretative authority implicitly—by failing to legislate in sufficient detail as to resolve a particular question of interpretation"), *cert. denied*, 479 U.S. 939 (1986); Scalia, *Judicial Deference To Administrative In-*

tory and purposes of its enabling legislation as well as in its administration—frequently places the agency in a better position than a reviewing court not only to determine Congress' intent, but also to determine which interpretation of an ambiguous statutory phrase will best comport with the agency's overall mission and regulatory priorities.[16] Third, deference to agency interpretations preserves an agency's flexibility to adapt its statutory mandate to changing needs.[17]

Each of these considerations applies with equal force to an agency's interpretation of both "jurisdictional" and "substantive" provisions. There is no reason to assume that when Congress defines the limits of an agency's jurisdiction in ambiguous terms, the ambiguity should not be resolved by the agency. That process of implementing Congress' intent is no different for a jurisdictional provision than for a substantive one.[18] Nor is there any reason to assume that Congress would not have entrusted the agency with a measure of discretion to define its own jurisdiction. Federal courts have been authorized to decide for themselves the sweep of their jurisdiction since the Judiciary Act was passed by the First Congress.

Similarly, an agency's expertise is not inherently less valuable when it interprets jurisdictional provisions: An agency certainly may have unique insights into the intended scope of its powers by virtue of its involvement in drafting the legislation and in commenting on potential amendments. Moreover, an agency's familiarity with its own regulatory program will inevitably give it an advantage in assessing the practical effects of a broader or narrower reading of its statutory authority.[19] And an agency's ability to decide the scope of its authority is just as important—with respect to its ability to adapt its administrative scheme to the regulatory needs of the day—

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terpretations Of Law, 1989 Duke L.J. 511, 516 ("*Chevron* . . . replaced this statute-by-statute evaluation [of prior decisions] . . . with an across-the-board presumption that, in the case of ambiguity, agency discretion is meant").

[16] See *Aluminum Co. of America* v. *Central Lincoln Peoples' Util. Dist.*, 467 U.S. 380, 389-90 (1984) (deference particularly appropriate because agency was "intimately involved in the drafting and consideration of the statute by Congress"); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965) (deference accorded to agency "charged with the responsibility of setting [the act's] machinery in motion, of making the parts work efficiently and smoothly"); *NLRB* v. *Hearst Publications*, 322 U.S. 111, 130 (1944) (agency's "everyday experience in the administration of the statute gives it familiarity with the circumstances and backgrounds of employment relationships in various industries").

[17] See Starr, *Judicial Review in the Post-Chevron Era*, 3 Yale J. on Reg. 283, 297 (1986) ("[T]o engage in informed rulemaking, the agency must consider varying interpretations and the wisdom of its policy on a continuing basis") (quoting *Chevron*, 467 U.S. at 863). See also Scalia, *Judicial Deference To Administrative Interpretations of Law*, 1989 Duke L.J. 511, 517-18 ("One of the major disadvantages of having the courts resolve ambiguities is that they resolve them for ever and ever; only statutory amendment can produce a change").

[18] Indeed, there is often no meaningful distinction between jurisdictional issues and issues involving the "mere" application of an agency's authority. See *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354, 380 (1988) (Scalia, J., concurring). An agency's interpretation of key substantive provisions may have far-reaching consequences for the scope of that agency's jurisdiction. See, *e.g.*, *Bayside Enterprises, Inc.* v. *NLRB*, 429 U.S. 298, 302-03 (1977) (deferring to agency's determination that employees not "agricultural laborers" and therefore not exempt from labor legislation); *NLRB* v. *Hearst Publications*, 322 U.S. at 130 (deferring to agency's determination that newsboys were "employees" within meaning of labor act).

[19] See, *e.g.*, *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 845 (1986) ("An agency's experience is superior to that of a court when a dispute centers on whether a particular regulation is reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the act the agency is charged with enforcing"); *Massachusetts* v. *Morash*, 109 S.Ct. 1668, 1674 (1989); *INS* v. *Jong Ha Wang*, 450 U.S. 139, 144 (1981) (per curiam).

as its ability to interpret its organic statute's substantive requirements.[20]

Accordingly, this Court has often accorded *Chevron* deference to agency interpretations of jurisdictional provisions arising under an agency's organic statute. In *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833 (1986), for example, the issue was whether the CFTC had jurisdiction over common law counterclaims arising out of the same transaction that gave rise to a reparations complaint. The Court deferred to the CFTC's position that it had jurisdiction, expressly rejecting the argument that the agency's expertise was irrelevant because of the "statutory jurisdictional-interpretation" nature of the issue. *Id.* at 845. The Court has also recently noted its long-standing deference to the NLRB's construction of the NLRA, regardless whether the disputed provisions construed are "substantive," "legal" or "jurisdictional." *NLRB* v. *City Disposal Sys.*, 465 U.S. 822, 830 n.7 (1984). See also *Dole* v. *United Steelworkers of America*, 110 S.Ct. 929, 944 (1990) (White, J., dissenting, joined by Rehnquist, C.J.) (application of *Chevron* deference cannot be avoided on the basis that the challenged interpretations concern the agency's jurisdiction); *Mississippi Power & Light Co.*, 487 U.S. at 378 (Scalia, J., concurring) (same).

2. The traditional reasons for deferring to a reasonable agency interpretation of its own organic statutes also apply to Section 318. First, Congress placed Section 318 in the FPA, thereby implicitly delegating to the FPC authority to resolve any ambiguity in that provision. Second, the FERC's predecessor—the FPC—drafted the original version of the Federal Power Act and testified

[20] See, *e.g.*, *NLRB* v. *City Disposal Sys.*, 465 U.S. 822, 839-40 n.7 (1984) (NLRB's construction of "concerted activity" was reasonable, especially in light of "Board's special function of applying the general provisions of the Act to the complexities of industrial life").

several times during Congress' consideration of that Act.[21] Third, the FERC is best situated to determine what impact various interpretations of Section 318 might have on its statutory mandate to ensure just and reasonable rates. Here, it recognized that depriving it of jurisdiction to regulate wholesale rates would create a regulatory gap that would prevent it from protecting millions of consumers.

The only feature of Section 318 that differs from other jurisdictional provisions is that, as the court of appeals observed (Pet. App. 9a), Section 318 implicates the authority of the SEC as well as the FERC. But, given Congress' decision to include Section 318 in the FERC's organic statute, it is reasonable to assume that Congress intended the FERC, rather than the SEC, to resolve any ambiguities that might arise in the application of that provision. The Court need not decide that question in this case, however, because the SEC agrees with the FERC's interpretation that Section 318 applies only in cases of actual conflict. See Brief for Federal Respondent.[22] Regardless of whether Congress would have preferred that any ambiguities in Section 318 be resolved by the SEC or the FERC, it cannot be presumed, consistent with *Chevron* and its rationale, to have intended that such ambiguities be resolved by the judicial branch in defiance of the views of both Commissions.

[21] See *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515, 525 (1945); *Senate Hearings* at 223-76; *House Hearings* at 384-488. DeVane, *supra*, 14 Geo. Wash. L. Rev. at 34.

[22] The last time Section 318 was before this Court, the SEC stated:

> Section 318 of the Public Utility Act of 1935 resolves the question of possible *conflicting requirements* of [PUHCA] and rules, regulations, and orders thereunder with the [FPA] and rules, regulations and orders thereunder by providing that in case of conflicts the requirements of the former Act shall prevail.

Respondents' Br. App. D. at 98-99. *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944) (emphasis added).

III. SECTION 318 DOES NOT OUST THE FERC OF ITS AUTHORITY TO PREVENT OHIO POWER FROM CHARGING UNJUST AND UNREASONABLE RATES FOR WHOLESALE ELECTRICITY BASED ON ABOVE-MARKET COAL PRICES.

Whether the meaning of Section 318 is resolved by resorting to Congress' intent or by deferring to the FERC, the proper interpretation is clear: Section 318 does not oust the FERC of its ratemaking authority unless there is an actual conflict between a requirement of the FERC under the FPA and a requirement of the SEC under PUHCA with respect to the same "subject matter." There are no conflicting requirements in this case.

1,. Nothing in Section 13(b), the SEC regulations or the SEC orders regarding SOCCO imposes any "requirement" on Ohio Power within the meaning of Section 318. Pet. App. 20a-23a (Mivka, J., concurring). "Require," the root of "requirement," means "to demand as necessary or essential." *Webster's Third New International Dictionary* 1929 (1971); see *Black's Law Dictionary* 1172 (5th ed. 1979) ("[to] direct, order, demand, instruct, command, claim, compel, request, need [or] exact"). It is not enough to conclude, as the court of appeals did, that a conflict exists simply because a certain activity of a company might fall within the potential scope of Section 13. Rather, it is necessary to determine the specific demands placed on Ohio Power under the PUHCA and under the FPA.[23]

[23] The SEC has plainly stated:

> Until the S.E.C. does by rule or order impose "requirements" . . ., there can be no conflict of requirements and Sec. 318 does not apply. It was not intended that utility companies should be able to thwart regulation by the F.P.C. by conjuring up under Sec. 318 imaginary conflicts with potential action of the S.E.C.

Respondents' Br. App. D at 98-99, *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944). In addition, in commenting on a FERC report regarding the coal procurement policies of AEP, the SEC staff

Section 13(b) of PUHCA does not impose any requirements on Ohio Power. By its terms, that provision does not *require* that inter-affiliate contracts be performed "at cost." It merely directs the SEC to enact regulations to "insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies." See 15 U.S.C. § 79m(b). The only "requirement" imposed directly by Section 13(b) is that affiliate contracts between the subsidiary and an associate operating company comply with regulations and orders of the SEC. *Id.*[24] Thus, there are no "requirements" unless the SEC imposes them.

The SEC's regulations, in turn, correctly view the "at cost" language in Section 13(b) as prohibiting only the payment of a price in *excess* of cost, consistent with Congress' intent to avoid "excessive charges" resulting from the lack of arm's-length bargaining between affiliates. See PUHCA § 1(b)(2); see also Pet. App. 21a (Mikva, J., concurring). Thus, the SEC regulations specifically

observed: "[t]here is no conflict with FERC jurisdiction, in setting rates FERC is legally bound to give due consideration to cost of service, which certainly includes cost of fuel burned, but there are a number of intermediary steps between our order authorizing an affiliate to acquire and mine coal reserves and the rate determination. . . ." Comment of the Division of Corporate Regulation of the Securities and Exchange Commission on the Federal Energy Regulatory Commission Staff Preliminary Report of Investigation in FERC Docket No. E-9206, dated July 31, 1978, quoted at Pet App. 38a.

[24] Indeed, Section 1(c) of PUHCA requires that PUHCA's terms "shall be interpreted to meet the problems and eliminate the evils as enumerated in this section." 15 U.S.C. § 79(c). One of those "evils" was the abuses arising from inter-affiliate contracts. See *supra* note 10. Because both the FERC and the SEC share responsibility over inter-affiliate contracts (see *supra* pp. 30-31), Section 13(b) should be construed in a way that preserves the FERC's authority as well as the SEC's authority.

prohibit the performance of sales contracts "at more than cost." 17 C.F.R. § 250.90(a)(2) (1989).[25]

The "orders" issued by the SEC and relied upon by Ohio Power in this case also do not place any demands or requirements on Ohio Power. As an initial matter, none of the orders *requires* Ohio Power to buy any coal from SOCCO at any price. Moreover, if Ohio Power chooses to take coal under its contract, the orders do not impose a minimum price for the captive coal, but merely establish a ceiling. The cost provisions of those orders are permissive, not mandatory. The most recent order, for example, provides that "[t]he price at which SOCCO's coal will be sold to AEP system companies will not exceed the cost thereof to the seller." *Southern Ohio Coal Co.*, HCAR No. 21537 (Apr. 25, 1980) (J.A. 93).[26]

Because nothing in PUHCA or the relevant SEC regulations and orders imposes any "requirement" on Ohio Power, Section 318 plainly does not apply. There can be no "actual conflict" between two regulatory regimes when one of those regimes imposes no requirement on the complaining party. *E.g.*, *Northwest Central Pipeline Corp.* v. *State Corp. Comm'n*, 109 S.Ct. 1262, 1277

[25] Indeed, SEC Rule 92 also imposes a ceiling at "the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere." 17 C.F.R. § 250.92(b). This rule therefore confirms that the "cost" standard embodied on Section 13(b) does not inevitably require that a utility company pay the actual out-of-pocket costs incurred by an affiliate.

[26] See also *Ohio Power Co.*, HCAR No. 20515 (Apr. 24, 1978) (J.A. 79) (price "will not exceed cost thereof to the seller"); cf. *Ohio Power Co.*, HCAR No. 17383 (Dec. 2, 1971) (J.A. 76) (charges will be "based on" actual cost). Under one of the orders, moreover, Ohio Power agreed to pay *less than* the cost of coal if its after-tax capital costs exceed a certain interest rate. *Southern Ohio Coal Co.*, HCAR No. 21008 (Apr. 17, 1979) (J.A. 85). Moreover, this ceiling price is not a finding or requirement imposed by the SEC; instead, the orders merely incorporate the statements made by Ohio Power and SOCCO in their applications. See *supra* p. 7.

n.13 (1989) (rejecting claim that state law conflicted with federal prudent-purchasing requirements because provision of state law "imposes no obligations on pipelines [and] obviously cannot make it 'impossible' for them to comply with federal law").

2. Even if PUHCA or the SEC's regulations or orders somehow imposed a requirement on Ohio Power to purchase coal from SOCCO and to pay SOCCO's "cost" of producing coal, such a requirement does not produce an acutal conflict with the FERC's determination that the full amount of those costs may not be passed on to Ohio Power's customers.[27] There is no conflict unless "'compliance with . . . regulations is a physical impossibility.'" *Pacific Gas & Elec. Co.* v. *State Energy Resources Conservation and Dev. Comm'n*, 461 U.S. 190, 204 (1983), quoting *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 142-43 (1963).[28] It is not physically impossible for Ohio Power to comply with the orders of both the SEC and the FERC.

First, as noted above, the SEC orders relied upon by Ohio Power establish only a *ceiling* price on the coal.

[27] The FERC's determination that "setting the intracorporate price and setting rates are not the same subject matter which would bring Section 318 into play" (Pet. App. 37a) essentially embodies this conflict analysis.

[28] The preemption cases on which the court of appeals relied are wholly inapposite. Pet. App. 9a, 10a-11a. In *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), this Court held that states may not reconsider FERC rate allocations under the filed rate doctrine. 476 U.S. at 963. The filed rate doctrine is firmly rooted in the FPA's grant of *exclusive* jurisdiction to the FERC vis-a-vis state regulators to set wholesale interstate electric rates, thereby preempting that field from any state regulation. See *id.* at 966. Here, where federal jurisdiction is explicitly granted to the FERC to regulate wholesale electric rates and the Public Utility Act contemplates a scheme of *concurrent* jurisdiction, any contention that the SEC has occupied the field is plainly without merit.

Because the market price set by the FERC is lower than this ceiling, the provisions are not incompatible.

Second, even though Ohio Power pays SOCCO the "costs" of coal, it is not required by anything in the SEC's regulations or orders to pass this cost along to its customers. Like any other utility whose costs are reviewed by the FERC, Ohio Power can simply absorb the difference between the "cost" and the recovery permitted by the FERC under a market-based price. It is certainly a known risk that not all of the actual costs incurred by the utility may be recoverable in a rate proceeding. In short, because Ohio Power can comply with both the SEC's and the FERC's orders, Section 318 creates no bar to implementation of FERC's rate determination.[29]

IV. THE DECISION BELOW CANNOT BE AFFIRMED ON THE ALTERNATIVE GROUND THAT THE FERC'S DECISION IS INCONSISTENT WITH ITS OWN REGULATION.

Ohio Power argued below that a FERC regulation, 18 C.F.R. § 35.14(a)(7), must be construed as creating a conclusive presumption that fuel costs incurred pursuant

[29] In addition, the SEC did not purport in any of its orders to determine the reasonableness or propriety of the price Ohio Power would pay for its coal. Indeed, *none* of these orders was issued pursuant to or in reliance upon the SEC's authority under Section 13(b). Those orders authorizd: (1) Ohio Power to inject capital in SOCCO pursuant to Sections 6(b), 9 and 10 of PUHCA, *Ohio Power Co.*, HCAR No. 17,383 (Dec. 2, 1971) (J.A. 76); (2) Ohio Power to inject additional capital in SOCCO and to sell mines and leases to SOCCO pursuant to Sections 6, 7, 9 and 10 of PUHCA, *Ohio Power Co.*, HCAR Holding Co. Act No. 20,515 (Apr. 24, 1978) (J.A. 79); (3) SOCCO to borrow funds pursuant to Sections 6, 7, 12(b), 12(c) and 12(f) of PUHCA, *Southern Ohio Coal Co.*, HCAR No. 21,008 (Apr. 17, 1979) (J.A. 85); and (4) SOCCO to receive additional capital from Ohio Power pursuant to Sections 6, 7, 9, 10 and 12 of PUHCA, *Southern Ohio Coal Co.*, HCAR No. 21,537 (Apr. 25, 1980) (J.A. 93). Any suggestion that permitting the FERC to exercise its ratemaking authority in this case would interfere with the SEC's regulatory objectives is fanciful.

to an inter-affiliate contract subject to the SEC's authority are just and reasonable.[30] The FERC rejected that argument. It held that the regulation merely creates a rebuttable presumption, which it found to be rebutted here. Pet. App. 40a-41a. The FERC's interpretation of its own regulation is entitled to the highest deference and cannot be rejected by a reviewing court unless it is unreasonable. See, *e.g.*, *Jewett* v. *Commissioner*, 455 U.S. 305, 318 (1982); *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965); *Union of Concerned Scientists* v. *NRC*, 711 F.2d 370, 381 (D.C. Cir. 1983) (administrative interpretation must be accepted unless it "flies in the face of the language of the rule itself"). The FERC's interpretation of Section 35.14(a)(7) is eminently reasonable for at least two reasons.

First, several courts have construed similar language—*i.e.*, "shall be deemed"—as creating a rebuttable rather than a conclusive presumption. In *Lavine* v. *Milne*, 424 U.S. 577 (1976), for example, this Court considered a provision of New York law providing that "a person who applies for [welfare] assistance within 75 days after voluntarily terminating his employment shall be 'deemed' to have done so [*i.e.*, terminated his employment] for the purpose of qualifying for such assistance . . ." *Id.* at 579 (quoting 18 NY Soc. Serv. Law § 131 (11) (Supp. 1975)). The Court held that the provision "merely makes absolutely clear the fact that the applicant bears the burden of proof on this issue . . ." (*id.* at 584), and expressly rejected the argument that the language of the provision "conclusively presumed" anything against the applicant. *Id.* at 584-85 n.9.[31]

[30] The rule provides, in part: "where a utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and includable in the adjustment clause." 18 C.F.R. § 35.14(a)(7).

[31] See also *Gaither* v. *Myers*, 404 F.2d 216, 219 n.5 (D.C. Cir. 1968) (noting that statute providing that driver of another's auto-

Second, the FERC's interpretation avoids the same regulatory gap that is left by the court of appeals' reading of Section 318. See *supra* pp. 32-34. A conclusive presumption of reasonableness would render the FERC powerless to prevent utilities from passing improperly inflated costs on to purchasers, and ultimately, consumers. The FERC has consistently interpreted the regulation to avoid that result. See *McDowell County Consumers Council* v. *American Elec. Power Co.*, 54 FPC 361 (1975); *McDowell County Consumers Council* v. *American Elec. Power Co.*, 15 FERC ¶ 61,257 at 61,592-93 (1981). This Court should respect that interpretation.

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mobile "shall be deemed" to be owner's agent may be rebutted): *Bowers* v. *United States*, 226 F.2d 424, 430-33 (5th Cir. 1955) (Cameron, J., dissenting) (citing numerous state supreme court cases); *Hardy* v. *Lomenzo*, 349 F. Supp. 617, 621 (S.D.N.Y. 1972) (provision of New York's election law stating that "no voters working for the government abroad shall be deemed to have lost their residence" does not create a conclusive presumption that an out-of-state voter working for government has retained his residence); *Sanitary Milk & Ice Cream Co.* v. *Hickman*, 193 S.E. 553, 555 (W. Va. 1937) (provision in sales tax law stating that certain associations "shall be deemed nonprofit" did not create conclusive presumption).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF ON BEHALF OF RESPONDENTS LCP CHEMICALS, INC., MORAY CORPORATION, OLIN CORPORATION, AND PPG INDUSTRIES, INC.

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BRIEF ON BEHALF OF RESPONDENTS LCP CHEMICALS, INC., MOBAY CORPORATION, OLIN CORPORATION, AND PPG INDUSTRIES, INC.

DESCRIPTION OF INDUSTRIAL RESPONDENTS

This brief is presented on behalf of LCP Chemicals, Inc., Mobay Corporation,* Olin Corporation, and PPG Industries, Inc., collectively referred to herein as "Industrial Respondents." Industrial Respondents were intervenors in the cases below before the Federal Energy Regulatory Commission and the Court of Appeals. Industrial Respondents are large West Virginia industrial

* Mobay Corporation is a wholly-owned subsidiary of Bayer, a German corporation.

retail electric service customers of Wheeling Power Company ("Wheeling"), an entire requirements wholesale customer of Respondent Ohio Power Company ("Ohio Power"). Wheeling and Ohio Power are two of the eight operating public utility subsidiaries of American Electric Power Company ("AEP").

Industrial Respondents collectively purchase 680 million to 820 million kilowatthours per year at retail rates set for Wheeling by the Public Service Commission of West Virginia ("PSCWV"). Industrial Respondents' electricity purchases represent approximately 42 percent of Wheeling's West Virginia retail business. The PSCWV includes in Wheeling's rates a component, adjusted at least semi-annually, to provide for recovery of the cost of wholesale power and energy it purchases from Ohio Power. Thus, the cost of power purchased by Industrial Respondents includes the cost of Wheeling's purchase from Ohio Power, including the cost at issue in this proceeding.[1]

Of the $19.394 million Ohio Power refunded to Wheeling on May 6, 1988 covering the period from July 1982 through January 1988, approximately $4.309 million or 42 percent would be due to the Industrial Respondents, exclusive of additional refunds and interest accruing since that time.

STATEMENT

Industrial Respondents accept and adopt the Brief filed by Petitioners, Arcadia, Ohio, et al.

All applicable statutes, regulations, decisions, and authorities are contained in the Brief filed by Petitioners, Arcadia, Ohio, et al.

[1] Ohio Power's wholesale rates to Wheeling and to petitioners are not identical but are affected in the same manner by the issues raised in the petition for certiorari.

CONCLUSION

The relief requested by Petitioners, Arcadia, Ohio, et al., should be granted.

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QUESTION PRESENTED FOR REVIEW

Whether section 318 of the Federal Power Act, 16 U.S.C. § 825q, prohibits the Federal Energy Regulatory Commission from limiting a utility to recovery of a "comparable market" price for coal purchased from an affiliated company when the Securities and Exchange Commission subjects the transaction to an "at cost" standard pursuant to the Public Utilities Holding Company Act, 15 U.S.C. §§ 79 *et seq.*

STATEMENT AS TO AFFILIATED COMPANIES

A list identifying the parent company and non-wholly owned subsidiary and affiliated companies of Ohio Power Company was provided at page i of the brief in opposition to the petition for certiorari.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1283

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENT OHIO POWER COMPANY

STATEMENT

Ohio Power Company (Ohio Power), as an affiliate of a registered utiiity holding company, is subject to regulation both by the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. §§ 79 *et seq.*, and by the Federal Energy Regulatory Commission (FERC) under the Federal Power Act (FPA), 16 U.S.C. §§ 824 *et seq.* In 1972, Ohio Power began the development, through an affiliate, Southern Ohio Coal Company (Southern Ohio), of certain coal mines in order to assure a reliable supply

of coal for particular generating facilities.[1] As required by section 9 of the PUHCA, 15 U.S.C. § 79i, Ohio Power applied for and received the approval of the SEC for its investment in Southern Ohio. In accordance with section 13(b) of the PUHCA, 15 U.S.C. § 79m(b), and the applicable SEC regulations, the contract between Ohio Power and Southern Ohio specified that the sale be made "at cost."

This case results from the refusal of the FERC to permit Ohio Power to recover in its wholesale rates the amounts it is obliged to pay to Southern Ohio under the cost-based contract, limiting recovery instead to a hypothetical market price. On review, a panel of the United States Court of Appeals for the District of Columbia Circuit vacated the decision of the FERC.

1. The Statutory and Regulatory Scheme. The Public Utility Act of 1935, 49 Stat. 803, 15 U.S.C. §§ 79 *et seq.*, (the 1935 Act), was an integrated response to concerns arising from the dominance of public utility holding companies in the early part of this century.[2] Title I added the PUHCA, 15 U.S.C. §§ 79 *et seq.*, conferring upon the SEC broad authority to regulate public utility holding companies. Title II added Parts II and III of the FPA, 16 U.S.C. §§ 824 *et seq.*, conferring upon the predecessor to the FERC, the Federal Power Commission (FPC), the authority to review the reasonableness of rates charged by public utilities to their wholesale customers in interstate commerce.

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[1] We use "affiliates" in this brief in its commonly understood sense of related entities under common control, rather than in the technical sense in which the term is used in the PUHCA. 15 U.S.C. § 79b(a)(11).

[2] Federal Trade Commission, Utility Corporations, S. Doc. No. 92, Parts 72-A & 73-A, 70th Cong., 1st Sess. (1935) ("FTC Report"). The reports that formed the basis of the 1935 Act have been called "some of the most exhaustive and comprehensive studies ever to underlie a federal statute." *North American Co. v. SEC*, 327 U.S. 686, 701 n.11 (1946).

One of the abuses of principal concern was the sale of goods and services by holding company subsidiaries to affiliated utility operating companies at inflated prices, which were then reflected in artificially high rates to consumers. FTC Report, Part 72-A, pp. 64, 467, Part 73-A, pp. 63, 70. *See also* Report of National Power Policy Committee on Public-Utility Holding Companies, S. Rep. No. 621, 74th Cong., 1st Sess. 56 (1935). In response, Congress decided to limit holding companies to such other businesses "as are reasonably incidental, or economically necessary or appropriate to" their utility operations. 15 U.S.C. § 79k(b)(1). Further, to guard against unnecessarily high rates to consumers, affiliate transactions were barred except under such "terms and conditions" as the SEC "by rules and regulations or order shall prescribe . . . to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost." 15 U.S.C. § 79m(b). The SEC is authorized to grant exemptions from the "at cost" requirement, by rule or order, if it determines that an exemption is "necessary or appropriate in the public interest or for the protection of investors or consumers" and if the transaction involves a foreign affiliate or "involve[s] special or unusual circumstances or [is] not in the ordinary course of business." *Id.*

The SEC has promulgated rules implementing section 13(b). Rule 90, 17 C.F.R. § 250.90 (1989), provides that, subject to certain exemptions, no transactions between holding company affiliates shall take place "at more than cost as determined pursuant to § 250.91 or any other applicable rule, regulation, or order of the Commission, or in the absence thereof, in accordance with sound methods of determining cost." In Rule 91, 17 C.F.R. § 250.91 (1989), the SEC specified the manner in which cost should be determined. In Rule 90(d)(2), 17 C.F.R. § 250.90(d)(2) (1989), and Rule 92, 17 C.F.R. § 250.92 (1989), the SEC provided an exemption and an

alternative standard for goods produced by the seller, stating that such goods shall not be sold "at a price which exceeds the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere."

Congress recognized that the regulatory responsibilities it assigned in the 1935 Act to the SEC and to the FPC could overlap. To ensure that regulated entities were not subject to duplicative regulatory requirements, Congress provided in section 318 of the FPA that when a person is subject to "a requirement of the Public Utility Holding Company Act of 1935 or of a rule, regulation, or order thereunder, . . . such person shall not be subject to the requirement of [the FPA], or of any rule, regulation, or order thereunder with respect to the same subject matter." 16 U.S.C. § 825q.

The FERC's regulations give effect to this provision in the case of fuel purchased from an affiliate:

> Where the utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and includable in the adjustment clause.

18 C.F.R. § 35.14(a)(7) (1989).[3]

2. The SEC's Review of Ohio Power's Coal Costs. Ohio Power is a wholly-owned subsidiary of the American Electric Power Company, Inc. (AEP), a registered public utility holding company that provides electric service at wholesale and retail over a seven-state area through

[3] "Adjustment clause" refers to a fuel adjustment clause, which is a mechanism through which increases or decreases in the cost of fuel (and, in some cases, other specified items) incurred by a utility are flowed through to ratepayers without the need for a rate filing. *See* 18 C.F.R. § 35.14(a)(1) (1989). Under cost of service regulation, a utility recovers its remaining costs of providing service through "base rates," which may be changed only through a rate filing with the appropriate regulatory agency.

eight operating companies. AEP is the nation's largest single user of coal. (R. 1664.) In the early 1970's, AEP anticipated that lower-sulfur coal, which would enable its generating plants to comply with new federal air emission standards, would become increasingly difficult and more costly to obtain. (R. 1534-35.) The urgency of these concerns was underscored by AEP's experience in the late 1960's, when coal prices rose dramatically and suppliers failed to honor commitments under long-term contracts, diverting coal to higher-priced spot markets. (R. 1535.) In addition, AEP then had under construction or in the planning stage 15,500 megawatts of generating capacity, which would require an additional 32.5 million tons of coal annually. (R. 1537.)

In 1971, the SEC authorized Ohio Power to create and to capitalize Southern Ohio, an affiliate, which would develop and operate coal mines "[i]n order to assure a reliable supply of coal for [Ohio Power's new] generating facilities." *Ohio Power Co.*, Holding Company Act Release No. 17383 at 1 (Dec. 2, 1971). The SEC specifically provided by order that "[t]he charges for coal by Southern Ohio will be based on an amount *equal to the actual cost* of Southern Ohio in developing the reserve and mining such coal," thereby indicating that the general standard set out in section 13(b) and Rules 90 and 91 would apply, and specified the manner in which the cost of capital was to be calculated. *Id.* at 2 (emphasis added). None of the coal to be mined by Southern Ohio was to be sold "to anyone other than public utility companies in the AEP system." *Id.* In accordance with this order, on October 1, 1972, Ohio Power entered into a contract with Southern Ohio, under which Ohio Power agreed to "receive, accept and pay for all of the coal produced by [Southern Ohio]," and to pay a price "equal to the entire cost to [Southern Ohio] of mining, preparing and delivering such coal." (R. 2676-77.) Subsequently, in a series of additional orders, the SEC reiterated that "[t]he price at which SOhio coal

is sold to AEP system companies *will not exceed* the cost thereof to the seller," the calculation of which was specified in some detail, approved Ohio Power's sale of coal mines and leases to Southern Ohio, approved borrowings by Southern Ohio to reduce its cost of capital, approved further investments by Ohio Power in Southern Ohio to finance efficiency improvements in mining operations, and required both Ohio Power and Southern Ohio to file quarterly financial information and statements setting out "the quantities of coal sold to each buyer, the price of such coal and the method used to compute the cost of coal sold."[4]

3. The FERC Proceedings. In 1982, Ohio Power made a rate filing with the FERC pursuant to section 205 of the Federal Power Act, 16 U.S.C. § 824d. All issues were settled except the extent to which Ohio Power could include its costs for "captive coal" purchased from Southern Ohio in its fuel adjustment clause.

As the Administrative Law Judge (ALJ) found, "[b]y 1978 the Martinka mine [operated by Southern Ohio] was in commercial operation and it was decided to use the Martinka coal at Mitchell [an Ohio Power generating unit that had previously experienced operational problems due to poor quality coal] and the results have been very favorable." (Jt. App., p. 15.) The higher quality coal enabled the generating unit to increase its effective availability from 62 to 74 percent, which produced savings to customers of 24 to 36 million dollars. (R. 1609-11.) The ALJ referred to the evidence showing "that it makes economic sense for OPCO to use a coal of the quality of that from the Martinka mine even if it is more expensive than the coal used in the past" as "persuasive" and "unchallenged." (Jt. App., pp. 47, 49).

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[4] *Ohio Power Co.*, Holding Company Act Release No. 20515, 14 SEC Docket 928, 929, 930 (1978) (emphasis added). *See also Southern Ohio Coal Co.*, Holding Company Act Release No. 21008, 17 SEC Docket 310 (1979); *Southern Ohio Coal Co.*, Holding Company Act Release No. 21537, 19 SEC Docket 1309 (1980).

Further, the Judge found that Ohio Power was prudent in acquiring rights to Martinka coal, that the Martinka mine has been "efficiently developed and operated" (*id.*, p. 69) and that the inclusion of such coal costs in Ohio Power's wholesale rates for the three years in question (1980 to 1982) was reasonable (*id.*, p. 75).

The FERC reversed. Without questioning the findings that Ohio Power was prudent to acquire the Martinka mine and that the mine had been efficiently operated, without even mentioning the benefits of assuring a long-term supply of high quality coal or the resulting savings realized by consumers, and dismissing as "fortuitous" the environmental benefits provided by the lower-sulfur coal (Pet. App., p. 47a), the FERC directed Ohio Power to refund the difference between the cost-based price paid to Southern Ohio and a calculated hypothetical market price (*id.*, p. 64a). The FERC viewed the application of a market standard to have been resolved in its earlier decision in *Public Service Co. of New Mexico*, 17 FERC Rep. (CCH) ¶ 61,123 (1981), *aff'd*, 832 F.2d 1201 (10th Cir. 1987), which did not involve a utility subject to section 13(b) of the PUHCA. It refused, either under section 318 of the FPA or its own rules, to defer to the cost-based method of pricing the Martinka coal mandated by the SEC's regulations and orders. With respect to the statute, the FERC concluded that "setting the intra-corporate price and setting rates are not the same subject matter which would bring section 318 into play." (Pet. App., p. 37a.) Although the FERC was uncertain as to the meaning of the SEC's orders, it concluded that, "[t]hey do not appear to mandate the cost-based price where a market price would be lower." (*Id.*, p. 36a.) The FERC ordered Ohio Power to revise its fuel adjustment clause to provide for the automatic recovery of "the comparable market price [for coal mined by Southern Ohio], regardless of whether the price is higher or lower than costs." (*Id.*, p. 63a.)

4. The Decision Below. The court below unanimously vacated the decision of the FERC. *Ohio Power Co. v. FERC*, 880 F.2d 1400 (D.C. Cir. 1989) (Pet. App., pp. 1a-28a). After noting that the FERC itself did not claim that its interpretation of section 318 was entitled to deference under this Court's decision in *Chevron, U.S.A., Inc., v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and its progeny, the panel majority found that such deference would not, in any event, be appropriate since section 318 was not entrusted to the FERC's administration. Recognizing that the FERC had, in effect, set a different price term than had been set by the SEC for the cost of affiliate coal, the court found "[t]he conclusion that the same subject matter is implicated is inescapable." (Pet. App., pp. 9a-10a.) Under the FERC's reasoning, the court observed, "there could never be a conflict between the SEC and FERC with respect to a matter not specifically enumerated in section 318" and it was not inclined to render "the residuary language of section 318 meaningless." (Pet. App., p. 10a.) Further, the court noted that regulation under the PUHCA included the charge that the SEC "exercise its power in the interest of consumers, as well as of investors and the public, and 'to insure that such contracts are performed *economically and efficiently*,' as well as 'at cost.' 15 U.S.C. § 79m(b) (emphasis added)." (Pet. App., p. 10a.)

As to the argument that there was no present conflict between the agencies' requirements as long as the market price was below cost, the court concluded that it is sufficient, under section 318, that a person is subject to a requirement under the PUHCA and that "[t]he fact that FERC's market approach produces a current result that does 'not exceed' cost" does not make the requirements of PUHCA inapplicable. (Pet. App., p. 14a.) Cognizant of this Court's precedents "that disfavor conflicting regulations resulting in trapped costs," *see, e.g., Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), the majority found that the market-based test adopted by the FERC would impermissibly create trapped costs when applied to transactions regulated by the SEC under an "at cost" standard. (Pet. App., p. 16a.) In any event, the court concluded payment of a market-based price when it is in excess of cost cannot be reconciled with the SEC's cost limitation. (Pet. App., p. 18a.)

The third member of the panel agreed that the same subject matter, within the meaning of section 318, was before both agencies. (Pet. App., pp. 19a, 20a.) He concluded, however, that section 318 was inapplicable because there was no actual conflict between the requirements imposed by the two agencies as long as the market price to which the FERC limited Ohio Power was below the cost-based price mandated by the SEC. He noted that he, too, would find such a conflict, and would require that the FERC yield in favor of the SEC, if the market price imposed by the FERC were higher than the cost-based price. (Pet. App., p. 23a.) Although he disagreed on the issue of statutory construction, he agreed that the FERC's decision must be vacated for failure to comply with the FERC's own regulation (quoted, *supra* p. 4). The majority had no occasion to reach that issue.

SUMMARY OF ARGUMENT

The central underpinning of the FERC's order was its view that section 318 is inapplicable because "setting the intra-corporate price and setting rates are not the same subject matter which would bring section 318 into play." (Pet. App., p. 37a). A unanimous court below disagreed, holding that precisely the same subject matter—the reasonableness of the price that Ohio Power pays to Southern Ohio—was at issue. (*Id.*, pp. 9a, 20a.) Before this Court, both Petitioners and the Government abandon the FERC's "different subject matters" rationale. There is also agreement that Ohio Power is subject to a require-

ment imposed by the SEC with respect to that subject matter—that the transfer price be based on "cost." The FERC's attempt to substitute a different standard—market—for fixing that transfer price must fail because the SEC has spoken to the precise subject matter that the FERC seeks to regulate.

Before this Court, the FERC for the first time argues that its market price standard should be sustained if it is a "consistent, concurrent" requirement, and therefore does not conflict with the SEC's cost standard. The FERC requests a remand to allow the court below to determine whether, under the requirement imposed by the SEC, the transfer price must always be "at cost" or "not in excess of cost," thereby implying that the FERC's specification of a market price would be "consistent" with the cost requirement imposed by the SEC, if the SEC establishes only a ceiling price *and* if market is below cost.

There is no occasion for a remand. The FERC's order provides that the market standard applies *both* when the market price is below the cost-based price *and* when the market price is above the cost-based price. Indeed, the across-the-board application of the market test was central to the FERC's rationale, is required by the agency's precedents, and will, under the FERC's order, occur without further action by the agency. All members of the court below agreed that when the market price, as the FERC calculates it, is above the cost-based price—as has in fact sometimes been the case since the FERC's order was issued—there is a conflict between the regulatory requirements imposed by the FERC and those imposed by the SEC. It is of no import, therefore, whether the SEC has established an "at cost" price or only a cost limitation. In neither event is it possible to reconcile a market price in *excess* of cost. Even if section 318 applies only in cases of "actual conflict," the FERC's order must be reversed.

Instead of defending the FERC's actual order, Petitioners and the Government urge the Court to review

a hypothetical ruling, which the FERC expressly disclaimed any intention of making: the imposition of a lower-of-cost-or-market standard for affiliate transactions within holding companies. No purpose would be served by such review. Moreover, a lower-of-cost-or-market standard, which is tantamount to a prohibition on vertical integration by holding companies into non-utility businesses, is incompatible with Congress' objective in the PUHCA of permitting affiliate transactions that are "reasonably incidental, or economically necessary or appropriate to" the holding company's utility operations, 15 U.S.C. § 79k(b)(1), subject to a cost standard. Application of a lower-of-cost-or-market standard would stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190, 204 (1983), quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941), and would therefore conflict with the "at cost" standard specified in the PUHCA. As applied here, it would ensure that the AEP system will suffer significant losses on investments made to secure a reliable supply of operationally and environmentally preferable coal, even though the SEC approved the investment, and the FERC agreed both that it was a prudent commitment and that the mine has since been efficiently operated.

Finally, affirmance would not give rise to a regulatory gap of *any* proportion. Under the analysis of the court below, when the PUHCA or the SEC's rules and orders thereunder have not imposed a requirement with respect to a particular subject matter, the FERC is free to do so, assuming it otherwise enjoys legislative competence. The bond of regulatory protection is complete. In the final analysis, Petitioners' complaint appears not to be addressed to a regulatory gap, but to dissatisfaction with the allocation of regulatory responsibilty. That, however, is an issue for Congress.

ARGUMENT

I. SINCE NEITHER PETITIONERS NOR THE FERC DEFENDS THE INTERPRETATION THAT THE FERC GAVE TO SECTION 318, NO ISSUE REGARDING THE APPLICATION OF *CHEVRON* IS RAISED.

In its order in this case, the FERC held that it was free to apply a market test to Ohio Power's purchase of coal from Southern Ohio, because, in its view, different subject matters, within the meaning of section 318, were before the FERC and the SEC. (Pet. App., pp. 37a-40a.) Petitioners urged this Court to review this case principally because they believed the Court of Appeals paid insufficient deference, under *Chevron, U.S.A., Inc.*, and its progeny, to this interpretation of the statute. (Pet., pp. 12-13.) In their briefs on the merits, however, neither Petitioners nor the FERC (now joined by the SEC) even attempts to support the interpretation on which the agency's order was based. The FERC in fact contends that whether the FERC and the SEC have imposed requirements with respect to the same subject matter is irrelevant to the application of section 318. (FERC Br., p. 35 n. 23.) [5] There is thus complete agreement, as there was among the members of the court below (*see* Pet. App., p. 19a), that the same "subject matter" was before the FERC and the SEC. No issue of the degree of deference, if any, to be accorded the FERC's decision to the contrary is before the Court.

Petitioners and the FERC instead argue that an "actual conflict" between the requirements imposed by the SEC and those imposed by the FERC is necessary for section 318 to apply (the second question presented

[5] In the same vein, Petitioners now concede that in the case of conflict, "Section 318 deprives the FERC of its ratemaking authority" (Pet. Br., p. 17), disavowing the FERC's view that no decision of the SEC could affect its authority because the SEC does not set rates.

in the Petition). While we address the merits of this argument *infra*, it is important to recognize that it, too, raises no issue of deference because it does not support the FERC's order and was not relied upon by the agency.

The FERC's order discussed the regulations and orders of the SEC and concluded, "[t]hey do not appear to mandate the cost-based price where a market price would be lower, rather they permit a price up to a cost-based price," implying that section 318 did not apply in that situation. (Pet. App., p. 36a.) The FERC left no doubt, however, that it was not relying on the fact that, at the time of its order, market was lower than cost, because it was prescribing a market price "*regardless* of whether the price is higher or lower than costs." (*Id.*, p. 63a; emphasis added.)

The application of a market price test when market exceeds cost was central to the FERC's decision: "Under the rationale of tying affiliate coal costs to the comparable market price, not only must cost recovery be limited to the market price when actual costs exceed market price, but fuel charges *must* be allowed up to the market price, even if actual costs are less." (*Id.*; emphasis added.) The FERC characterized its decision as simply an application of the market-price test it announced in *Public Service Co. of New Mexico*, where it permitted a utility not subject to section 13(b) to recover the market price of coal purchased from an affiliate, which price exceeded cost. (Pet. App., pp. 42a-44a.) [6] Further, the FERC ordered Ohio Power to modify its fuel adjustment clause to provide for the recovery of an amount up to the market price for all coal purchased from Southern Ohio, without regard to whether market price exceeds cost. (Pet. App., p. 66a.) Because the fuel adjustment clause

[6] As the FERC noted (Pet. App., p. 42a), until the *New Mexico* decision, the FERC and the FPC applied a cost test to affiliate transactions.

operates automatically (*see supra* n. 3), no further action by the FERC is required for Ohio Power to recover the "comparable market" price when that price exceeds cost. In fact, the market price, calculated in accordance with the FERC's methodology, has exceeded the cost of mining Martinka coal in some months, and did so even before the FERC's order on rehearing was issued.[7]

It is common ground that an "actual conflict" exists when the market price exceeds the cost-based price, even if, as the FERC believed, the SEC's orders only establish cost as a ceiling.[8] Since the application of a market price in that circumstance was central to the FERC's rationale, the agency justified its disallowance of the coal costs incurred by Ohio Power by relying on its "different subject matters" reasoning, and did not even mention the fact (which it had noted earlier) that its market approach at that time produced a result that did not exceed cost. (Pet. App., pp. 61a-63a.) Therefore, even if the "no actual conflict" argument advanced by Petitioners in their petition and on brief had merit, it would not support the agency's orders. *See FPC v. Texaco, Inc.*, 417 U.S. 380, 397 (1974) (agency's order must be affirmed on the basis relied upon in its opinion, or not at all); *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962) (rejecting "*post hoc* rationalizations" of appellate counsel). Although Petitioners and the FERC argue that deference should be paid to the FERC counsel's present position that an actual conflict is an additional prerequisite to the applicability of section 318, no justification has been offered for deference to an argument advanced by counsel, that, although mentioned in the agency's order, is inconsistent with the agency's rationale, does not support the agency action under review, and was not relied upon by the agency for that purpose. *See Bowen v. Georgetown Univ. Hosp.*, 109 S. Ct. 468, 473 (1988); *Investment Co. Inst. v. Camp*, 401 U.S. 617, 628 (1971).[9]

Since neither Petitioners nor the Government supports the FERC's interpretation that different subject matters were before the two agencies, no issue is presented regarding the deference, if any, to be given to that interpretation. Indeed, as Petitioners recognize (Pet., p. 12), the FERC's decision to prescribe a market test whether the market price is above or below cost could *only* be supported, if at all, on the "different subject matters" rationale. Once it is conceded that the same subject matter was before the FERC and the SEC, the FERC's decision *must* be vacated. No point would be served by undertaking a review of whether a different, hypothetical

[7] Market price exceeded cost in both November and December 1987. Ohio Power Co., Compliance Filing, FERC Docket Nos. ER82-533-004, *et al.* (May 9, 1988).

[8] The concurring member of the panel below noted, "if the market price determined by FERC were higher than cost . . . then FERC's requirement would clearly conflict with the SEC's requirement and, under section 318, FERC would have to abide by the SEC's determination." (Pet. App., p. 23a.) The FERC's request for a remand to determine whether the SEC's orders fix cost as the price, or only set a ceiling price (FERC Br., p. 11), indicates that the FERC, too, believes a conflict exists if market price exceeds cost. Petitioners have advised the Court that "the SEC's regulations merely establish an upper limit on the price SOCCO may charge" (Br., p. 15); that "the SEC regulations specifically prohibit the performance of sales contracts 'at more than cost.' 17 C.F.R. § 250.90(a)(2) (1989)" (*id.*, pp. 41-42); and that "the SEC orders relied upon by Ohio Power establish only a *ceiling* price on the coal" (*id.*, p. 43). Similarly, the Indiana Municipal Power Agency concedes that there would be a conflict if FERC authorized Ohio Power to pay in excess of cost. (Br., p. 17 n. 13.)

[9] Nor does the fact that the SEC has joined in the FERC's brief before this Court advance Petitioners' deference claims, especially since the brief does not support, and the SEC has thus not joined in, the FERC's "different subject matters" argument. *See ETSI Pipeline Project v. Missouri*, 484 U.S. 495, 516-17 (1988) (plain language of statute precludes Secretary of the Interior from exercising authority delegated to the Secretary of the Army, regardless of the latter's concurrence).

FERC ruling, limiting recovery in affiliate transactions to the lower-of-cost-or-market, would be consistent with the scheme of cost-based regulation under the PUHCA.[10]

II. THE COURT OF APPEALS CORRECTLY HELD THAT SECTION 318 PROHIBITS THE FERC'S PRESCRIPTION OF A MARKET TEST FOR A TRANSACTION SUBJECT TO THE COST STANDARD SPECIFIED IN SECTION 13(b) OF THE PUHCA AND IN THE IMPLEMENTING SEC REGULATIONS AND ORDERS.

Petitioners, joined by the FERC, contend that the principal failure of the Court of Appeals was its application of a "field preemption" analysis to determine the applicability of section 318. This contention and the related assertion that the analysis of that court could have far-reaching and untoward results mischaracterize the decision below. The repeated incantation of "field preemption" cannot obscure the failure of Petitioners and the Government to address whether "the same subject matter" was before the FERC and the SEC, or even to describe the bounds of the "field" from which they believe the decision below excluded the FERC. The Court of Appeals did *not* hold—as it would have had it employed a field preemption analysis—that the FERC, when operating in its own sphere of setting wholesale rates for electricity, was precluded by section 318 from regulating any aspect of transactions between affiliates within holding companies. *See Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 298-99 (1988); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Instead, it determined that the FERC could not impose a "requirement" with respect to the narrow "subject matter" covered by section 13(b) of the PUHCA and the implementing rules and

[10] For this reason, the Court should consider dismissing the petition as improvidently granted. *See Jones v. Hildebrant*, 432 U.S. 183 (1977) (issue framed in the petition and passed upon below not advanced in oral argument).

orders of the SEC: the standard by which the reasonableness of the price in a transaction between holding company affiliates is determined. Only in this narrow "field" did the majority below find that the FERC was precluded from imposing additional requirements. This carefully channeled analysis, which flows directly from the plain language of section 318, hardly leads to the parade of horribles presented by Petitioners and the FERC.

Further, the court below went on to undertake precisely the "pragmatic analysis" now advocated by the FERC: it explored the purposes for which the SEC was directed by Congress to enforce a cost standard and probed the practical effect of the coexistence of the FERC's market price requirement and the requirement that had been imposed by the SEC. The court concluded that the FERC's market-price test, applicable whether market is above or below cost, is fundamentally incompatible with cost-based regulation of the Ohio Power-Southern Ohio transactions by the SEC. As we show below, the Court of Appeals' conclusion with respect to FERC's actual ruling was plainly correct. Further, even if the FERC had intended to impose a lower-of-cost-or-market test—which it clearly did not—such a ruling would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in enacting the PUHCA.

A. Section 318 Prohibits the FERC From Imposing a Market Test Because Ohio Power Is Subject to a Requirement Imposed By the SEC Under the PUHCA With Respect to the Price Standard To Be Applied to Its Purchase of Coal From Southern Ohio.

Section 318 of the FPA provides, in terms that are unmistakable, that if a person is "subject" to a requirement of PUHCA, "or of a rule, regulation, or order thereunder . . . such person shall not be subject to [a] requirement of [the FPA] or of any rule, regulation or

order thereunder, with respect to the same subject matter" absent the issuance of an exemption by the SEC. 16 U.S.C. § 825q. The court below found unanimously, and no one disputes before this Court, that the SEC and the FERC were each seeking to regulate the same subject matter—the price to be paid by Ohio Power for coal purchased from Southern Ohio. Nor, as we demonstrate presently, is that finding subject to credible challenge. The remaining question, under section 318, is whether Ohio Power is subject to a "requirement" imposed by the SEC with respect to that subject matter. Again, the issue is not subject to serious dispute. (Pet. App., p. 5a.)

In approving the purchase of coal from Southern Ohio, the SEC required that the price to be paid by Ohio Power be based on "cost." [11] Whether cost was to establish the price floor as well as the price ceiling is of no current moment. What is significant is that the PUHCA and the SEC's implementing rules and orders established the regulatory *standard* that is to govern the transfer price—cost. It is that very transfer price that the FERC seeks to regulate—the amount that it will credit

[11] In the absence of the SEC's orders, it might be open to question whether the market test laid out in the SEC's Rule 92 for goods produced by the seller applied instead. As the court below found, however, the SEC's orders leave no doubt that this transaction is governed by a cost standard: "Rules 90 and 91 are regulations under section 13(b) and as binding thereunder as an individualized order." (Pet. App., p. 15a.) This is consistent with the SEC's regulation of other fuel supply affiliations of registered holding companies, which were also regulated on a cost basis. *See, e.g., New England Elec. Sys.*, Holding Company Act Release No. 20632, 15 SEC Docket 329 (1978); *Central and South West Corp.*, Holding Company Act Release No. 22635, 26 SEC Docket 159 (1982). In the only case in which the SEC authorized a market-price test, it issued an express exemption from section 13(b), thereby giving the FERC discretion to regulate the rate consequences of the transaction. *New England Elec. Sys.*, Holding Company Act Release No. 22309, 24 SEC Docket 298, 305-08 (1981).

to Ohio Power as the price of coal purchased from Southern Ohio. This is precisely what the FERC may not do, because the SEC has by order imposed a requirement with respect to the precise subject matter that the FERC seeks to regulate.

As the court below found (Pet. App., pp. 9a-10a), the FERC's assertion that the "subject matter" of its rulings is "setting rates" (*id.*, p. 37a), which was not before the SEC, effectively reads the phrase "or any other subject matter" out of section 318. It is an interpretation of section 318 that is "manifestly contrary to the statute." *Sullivan v. Zebley*, 110 S. Ct. 885, 890 (1990); *Chevron, U.S.A., Inc.*, 467 U.S. at 844.[12] The SEC *never* directly sets wholesale rates for electricity, as the Congress that gave that authority to the FPC in 1935 well knew. Under the FERC's interpretation, then, section 318 would apply, if at all, only to the enumerated subjects. The FERC's restrictive interpretation contradicts the ordinary meaning of the inclusive residuary language. Further, it fails to give effect to all of the words of the statute and, accordingly, cannot be credited. *See, e.g., Crandon v. United States*, 110 S. Ct. 997, 1008 (1990) (Scalia, J., concurring); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979); *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 392 (1940).

The structure and legislative history of the 1935 Act confirm the clearly expressed intent of Congress that the SEC, and not the FERC, regulate transactions between

[12] On brief, the FERC abandons this interpretation, asserting that it is irrelevant "whether the 'subject matter' as to which the SEC has imposed 'requirements' is the same as the 'subject matter' as to which FERC has imposed 'requirements.'" (FERC Br., p. 35 n. 23.) Statutory interpretation, however, must begin with the language of the statute. *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

affiliates within utility holding companies by applying a cost standard.[13] We are in agreement with the Government that a principal aim of the Congress in enacting the 1935 Act was to curb the practice of passing inflated prices on to utility consumers as a result of inter-affiliate transactions. (FERC Br., p. 5.)[14] In response, Congress did not decide to bar holding companies from entering non-utility businesses, but instead to permit them to engage only in such other businesses "as are

[13] This Court has held that, "[i]n ascertaining the plain meaning of the statute, the court must look to the particular statutory language at issue, as well as the language and design of the statute as a whole." *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988), citing *Bethesda Hosp. Ass'n v. Bowen*, 485 U.S. 399, 405 (1988). *See also Dole v. United Steelworkers*, 110 S. Ct. 929, 937 (1990) (statutory language unambiguous "in light of the language and structure of the Act as a whole").

[14] *See* 15 U.S.C. § 79a(b)(2). The FTC Report stated that its recommendation that affiliate transactions within holding companies be regulated was directed to an evil "which directly affect[s] the rate-paying public." FTC Report, Part 73-A, p. 70. Thomas Corcoran, one of the principal draftsmen of Title I of the 1935 Act, explained that while affiliate transactions at inflated prices also injured equity investors in operating utility subsidiaries of holding companies, such transactions were "unfair to the ratepayers, because ultimately the profit [to the holding company] has to come out of somebody." *The Public Utility Holding Company Act of 1935: Hearings on S.1725 Before the Senate Committee on Interstate Commerce*, 74th Cong., 1st Sess. 173 (1935) ("Senate Hearings"). FPC Commissioner Seavy agreed that both parts of the 1935 Act, the PUHCA and the FPA, were principally for "the benefit of the consumer," and explained that the PUHCA "affects the rates insofar as any unusual or unnecessary imposition of expenses upon the operating companies" is concerned. *The Public Utility Holding Company Act of 1935: Hearings on H.R. 5423 Before the House Committee on Interstate and Foreign Commerce*, 74th Cong., 1st Sess. 447-48 (1935) ("House Hearings"). *See also id.* at 343-45 (statement of Mr. Rayburn). Similar observations are found in the Congressional debate. 79 Cong. Rec. (1935) at 8391 (remarks of Sen. Norris); *id.* at 8392 (remarks of Sen. Shipstead); *id.* at 8399 (remarks of Sen. Costigan); *id.* at 8688-89 (remarks of Sen. Bone); *id.* at 8709-10 (remarks of Sen. Brown).

reasonably incidental, or economically necessary or appropriate to" their utility operations. 15 U.S.C. § 79k(b)(1). Congress also specified in section 13(b) that such transactions were to take place "at cost," to promote their economical and efficient performance and to protect consumers against paying excessive utility rates. 15 U.S.C. § 79m(b). Congress assigned the responsibility for regulating affiliate transactions within holding companies to the SEC, even though, in another part of the 1935 Act, it gave the FPC plenary authority over wholesale rates charged by utilities in interstate commerce. 16 U.S.C. §§ 824d, 824e.[15]

The specification of a cost standard in section 13(b) was both singular and deliberate. Alone among the substantive provisions of the 1935 Act, section 13(b) explicitly provides that affiliate transactions are to take place "at cost," rather than simply under a broadly defined public interest standard to be fleshed out by the agency.[16] This singularity is not accidental. The House

[15] As originally introduced, both the House and the Senate bills made regulation of affiliate transactions within holding companies the responsibility of the FPC, *not* the SEC. *See* H.R. 5423, 74th Cong., 1st Sess. §§ 12(a)-12(d) (1935); S. 1725, 74th Cong., 1st Sess. § 13(g) (1935). This feature was retained in the bill passed by the Senate, S. 2796, 74th Cong., 1st Sess. (1935). The House substitute bill, and ultimately the bill approved by the conference committee, placed authority over affiliate transactions in the SEC. *See* H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7 (1935).

[16] The other provisions of the 1935 Act gave the FPC or the SEC broadly defined authority to regulate in a manner "necessary in the public interest," 16 U.S.C. § 824, "necessary or appropriate in the public interest," 16 U.S.C. § 824a, "compatible with the public interest," 16 U.S.C. § 824c, or "necessary or appropriate in the public interest or for the protection of investors or consumers," 15 U.S.C. §§ 79b, 79e, 79f, 79g, 79j, 79k, 79*l*, 79m(a), 79n, 79o, 79q, 79t. The FPC was directed to ensure that rates for transmission and wholesale sales of electricity in interstate commerce are "just and reasonable," 16 U.S.C. §§ 824d, 824e, but the standard against which justness and reasonableness was to be measured

substitute bill amended the original Senate bill by eliminating the requirement that transactions between affiliated companies be made at cost, replacing it with a more general requirement, which merely made it unlawful for affiliates to contract in contravention of such rules and regulations "as the [SEC] deems necessary in the public interest or for the protection of investors or consumers." *See* H.R. Rep. No. 1318, 74th Cong., 1st Sess. 6, 19 (1935).

Deletion of the "at cost" standard evoked a sharp dissent. Congressman Eicher decried the deletion of "the very definite principle" that "intra-system service arrangements must be on a cost basis." *Id.* at 45, 53. The conference committee, in apparent response, restored the "at cost" standard. *See* H.R. Rep. 1903, 74th Cong., 1st Sess. 72 (1935). The legislation was enacted in this form. 15 U.S.C. § 79m(b).[17]

The FERC's reading of section 318 to permit it to override this clearly expressed Congressional determination eviscerates the 1935 Act's regulation of affiliate transactions. The FERC nowhere explains how the SEC can fulfill the congressional mandate to protect consumers against excessive rates due to abusive affiliate transactions by applying a cost standard if, when the FERC sets wholesale rates, it ignores the SEC's implementation

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was not specified. *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

[17] Petitioners' argument that Congress' express reinstitution of the cost standard in section 13(b) somehow supports the authority of the FERC to disregard that standard (Pet. Br., pp. 29-30) is untenable. The general standard in the House substitute bill was rejected not because it would have given the SEC ratemaking authority, but because Congress wanted to leave no doubt that a cost standard should be applied to affiliate transactions in holding companies. The general grant of authority to the FPC over wholesale rates cannot override the simultaneous specific grant of authority to the SEC to regulate affiliate transactions, using a cost standard. *See Morton v. Mancari*, 417 U.S. 535, 550-51 (1974).

of Congress' directive, subjecting those transactions instead to a market test. In fact, the FERC's construction makes the SEC's regulation under section 13(b) pointless. The "intra-corporate price" (Pet. App., p. 37a)—a term that appears nowhere in the 1935 Act—has no impact on consumers unless that price is reflected in electric rates paid by consumers. The FERC cannot suggest that Congress enacted section 13(b) in order to regulate meaningless bookkeeping entries among commonly-owned entities. Further, under the FERC's construction of section 318, a regulated entity could not ascertain the standard to be applied to a contemplated affiliate transaction unless it obtained prior rulings from *both* agencies. This, however, is precisely the type of duplicative regulation that section 318 was designed to preclude. The FERC's reading of section 318 simply cannot be squared with the language of that section or the integrated legislative scheme of the 1935 Act.

B. Even if an Actual Conflict Is Required for Section 318 To Apply, the FERC's Application of a Market Test, Whether Market Is Above or Below Cost, to a Transaction Governed by Section 13(b) of the PUHCA Conflicts With That Provision and the SEC's Regulations and Orders Implementing It.

Before this Court, the FERC argues for the first time that section 318 must be read to permit "concurrent, consistent regulation" by the FERC and the SEC (FERC Br., pp. 12, 13, 23), and urges a remand so that the Court of Appeals may interpret the SEC's orders to determine whether the FERC's market test is in fact "consistent" with the requirements imposed by the SEC.[18] The Court of Appeals, however, undertook precisely the type of "pragmatic" assessment urged by

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[18] Petitioners similarly assert that Congress intended to create "dual, complementary regulatory regimes." (Pet. Br., p. 25.)

the FERC, concluding that the requirement imposed by the FERC cannot be enforced "without running afoul of the SEC's bar" on the payment of an inter-affiliate price in excess of cost. (Pet. App., p. 18a.) Even if section 318 applies only in instances of "actual conflict," the FERC's comparable market test, applicable whether the market price is above or below the cost-based price, is manifestly inconsistent with the regime of cost-based regulation of affiliate transactions within holding companies enacted by Congress and implemented by the SEC.

1. The FERC's application of a market test to transactions subject to cost-based regulation under section 13(b) does not amount to "concurrent, consistent regulation." As the Court of Appeals recognized, the cost test and the market test are different means to the same end: the protection of consumers against excessive rates attributable to affiliate transactions. (Pet. App., p. 11a.)[19] The FERC believes that a market test better serves that end. Where a holding company subject to the PUHCA is concerned, however, Congress has chosen a cost standard. Neither the FERC nor this Court is free to disregard Congress' unambiguously expressed prefer-

[19] Petitioners concede that section 13(b) of the PUHCA "was designed to avoid 'excessive charges' incurred as a result of inter-affiliate contracts" (Br., p. 6), while the FERC's mandate under the FPA is similarly "to protect ratepayers from excessive charges" (*id.*, p. 8). Congress clearly intended the SEC to have ongoing oversight over affiliate transactions, giving the SEC the power to require companies performing contracts subject to section 13(b) to preserve accounts and other records, to provide them for the SEC's inspection and to keep accounts in the manner prescribed by the SEC. 15 U.S.C. §§ 79o(d), 79o(f), 79o(i). The SEC may also require holding companies to file reports that include information the SEC deems "necessary or appropriate to keep reasonably current the information filed under section [13]," 15 U.S.C. § 79n, a requirement that has been imposed on the Ohio Power-Southern Ohio transaction.

ence; the FERC's attempt to do so is hardly "complementary" to the SEC's implementation of the congressional directive.[20] Permitting the FERC to "take action which it thinks will best effectuate a federal policy . . . in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress." *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374-75 (1986). If the 1935 Act "falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the [agency] or the courts, to address." *Board of Governors v. Dimension Fin. Corp.*, 474 U.S. 361, 374 (1986). *See also K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 323 (1988) (Scalia, J., concurring and dissenting).

The SEC has also recognized, in a prepared statement submitted in 1982 to a congressional committee contemplating amendment or repeal of the PUHCA, that application of a cost test and a market test to the same transaction is neither "consistent" nor "complementary." The Chairman of the SEC stated that section 318 "provides for deference to the [SEC's] jurisdiction under the [PUHCA] when the [PUHCA] and the [FPA] contain overlapping provisions" and, therefore, the concurrent application of a market standard by the FERC and a cost standard by the SEC created a situation in which "that portion of the industry represented by the registered holding company systems is now subject to a different federal standard for determining affiliate transaction prices than that applied to the rest of the industry." *The Public Utility Holding Company Act of 1935: Hearings on H.R. 5220, H.R. 5465 and H.R. 6134 Before the Subcommittee on Energy Conservation and Power of the Committee on Energy and Commerce*, 97th Cong., 2d Sess. 582-83 (1982) (footnote omitted). The only authorita-

[20] That the FERC is free to use a market approach where it has been delegated unfettered regulatory discretion is unquestioned. *See Public Serv. Co. of New Mexico.*

tive statement of the SEC, which the Court of Appeals described as "[t]he clearest statement by anyone associated with the SEC" with respect to this issue (Pet. App., p. 13a), holds that, by virtue of section 318, the PUHCA's cost standard applies to affiliate transactions within holding companies to the exclusion of the FERC's market standard—a view diametrically opposed to that expressed in the FERC's order in this case.

2. As discussed *supra* pp. 13-14, the application of its market test when market exceeds cost is central to the FERC's order and its underlying rationale. Moreover, the FERC's order currently authorizes Ohio Power to collect through its wholesale fuel adjustment clause the excess of market over cost. The conflict between the FERC's market test and the SEC's cost standard is therefore clear, even if, as Petitioners contend, the SEC's regulations and orders only establish cost as a ceiling. The court below correctly noted that the FERC could not explain "how OPCO can recover in its rates . . . a fair market value in excess of cost without runing afoul of the SEC's bar" on payments above cost. (Pet. App., p. 18a.) On this point, the panel below was unanimous. (*Id.*, p. 23a.)

The FERC makes no attempt to offer the explanation that the Court of Appeals found lacking. Instead, it suggests that "[t]he court [below] did not decide whether the SEC orders required that SOCCO sell the coal to Ohio Power at cost, or instead merely set cost as a ceiling." (Br., p. 11). Accordingly, it urges a remand "to the court of appeals so that the necessary inquiry into the meaning of the four SEC orders can be undertaken" (*id.* at 36), recognizing that that issue, if pertinent, is addressed to the court, and not to the FERC. However, the issue as to which the FERC seeks a remand is of no moment. If section 13(b) and the SEC's regulations and orders require the payment only of actual cost—no more and no less—the conflict is plain. The conflict is equally

apparent if they merely establish cost as a ceiling. Since the effect of the FERC order is to sanction the precise circumstance that all members of the panel below recognize will give rise to an irreconcilable conflict, the remand the Government seeks would serve no purpose.

C. The FERC's Application of a Market Test to a Transaction Governed by Section 13(b) of the PUHCA Conflicts With the Requirements Imposed By the SEC When the Market Price Is Below Cost.

Petitioners contend that there is no conflict between the requirements imposed by the two agencies because "[i]t is not physically impossible for Ohio Power to comply with the orders of both the SEC and the FERC," as long as the market price determined by the FERC is below the cost-based price, as it was at the time of the FERC's order. (Pet. Br., p. 43.) Petitioners also argue that "Ohio Power can simply absorb the difference between the 'cost' and the recovery permitted by the FERC under a market-based price." (*Id.*, p. 44.)[21] Petitioners

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[21] Petitioners also contend that none of the SEC's orders "*requires* Ohio Power to buy any coal from [Southern Ohio]" (Pet. Br., p. 42; emphasis in original), although they do not develop this point. In fact, this contention is immaterial and inaccurate. First, section 13(b) of the PUHCA clearly *requires* application of a cost standard to any affiliate transaction that is permitted to take place, except where the SEC grants an exemption. As the court below found (Pet. App., p. 5a), it is "unquestioned" that the transaction between Ohio Power and Southern Ohio, having received SEC approval under section 9, is subject to a "requirement" under section 13(b) and the implementing SEC rules and orders. Second, the SEC approved Ohio Power's investment in coal mining properties through Southern Ohio because of the need "to assure a reliable supply of coal for [new Ohio Power] generating facilities." *Ohio Power Co.*, Holding Company Act Release No. 17383 at 1 (Dec. 2, 1971). To ensure that utility consumers benefitted from these investments, the SEC restricted sales of coal mined by Southern Ohio to AEP system utility operating companies. *Id.* at 2. The 1972 contract between Ohio Power and Southern Ohio, which was entered into as a result of this approval and which provides part of the

thus recognize that their argument effectively prescribes a "lower-of-cost-or-market" test, but pronounce themselves unconcerned by the "trapping" of costs that would result. The short answer to Petitioners' contention is that the FERC expressly disclaimed any intention to subject affiliate transactions to a lower-of-cost-or-market standard, recognizing that such a standard would be inequitable, inefficient, and potentially unconstitutional. (Pet. App., pp. 61a-64a.) Petitioners thus ask the Court to review a hypothetical ruling that was not before the court below.

Even if the FERC's order were limited to the situation when market is less than cost and had been intended to prescribe a lower-of-cost-or-market test, there is no support in the language, structure or history of the 1935 Act for the narrow reading that Petitioners give to section 318. The only authority cited for the proposition that current "physical impossibility" is a prerequisite for conflict is a preemption case, *Pacific Gas & Elec. Co.*, 461 U.S. at 204. However, this Court's preemption precedents, including *Pacific Gas & Electric*, recognize that a conflict between state and federal regulatory schemes also exists when state regulation "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *id.*, quoting *Hines v. Davidowitz*, 312 U.S. at 67, or when state regulation "interferes with the methods by which the federal statute was designed to reach [its] goal." *International Paper Co. v. Ouellette*, 479 U.S. 481, 494 (1987). *See also California v. FERC*, 58 U.S.L.W. 4591, 4595 (U.S. May 21, 1990) (No. 89-333). Limiting Ohio Power to a market

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security for the Southern Ohio financing approved by the SEC in 1979, *Southern Ohio Coal Co.*, Holding Company Act Release No. 21008, 17 SEC Docket 310, 311 (1979), is even more explicit, obligating Ohio Power to "receive, accept and pay for all of the coal produced by [Southern Ohio]." (R. 2676.) In fact, the FERC agreed that Ohio Power's decision to purchase coal from the Martinka mine was prudent. (Jt. App., p. 69; Pet. App., p. 65a.)

price when market is below cost indeed stands as an obstacle to the accomplishment of the full purposes and objectives of Congress in the PUHCA, and therefore presents an "actual conflict" with the requirement imposed by section 13(b), if a conflict is necessary for section 318 to apply.

1. *First*, nothing in the language or legislative history of section 318 signifies an intention to limit its application to instances where it is currently "physically impossible" for a regulated entity to comply with the requirements of the FERC and the SEC. Section 318 speaks not in terms of "impossibility," but in terms of the applicability of "requirements" with respect to "the same subject matter," 16 U.S.C. § 825q, directing an inquiry into the requirements that the SEC currently has in place and those the FERC seeks to impose. In this case, the SEC *has* imposed requirements: its current regulations and orders at a minimum set cost as a ceiling, while the FERC's current order limits Ohio Power to the "comparable market" price. Petitioners' reliance (Br., p. 18) on the heading of section 318 to limit the clear language of the statute is misplaced: "[T]he heading of a section cannot limit the plain meaning of the text." *Brotherhood of R.R. Trainmen v. Baltimore & O. R.R.*, 331 U.S. 519, 529 (1947). In fact, the heading of section 318 lends no support to Petitioners' "physical impossibility" argument. The heading, which reads, "Conflict of *Jurisdiction*," not "Conflict of Requirements," confirms that section 318 applies whenever there is a clash between the spheres of "jurisdiction" of the SEC and the FERC because each agency has imposed a "requirement" with respect to "the same subject matter." [22]

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[22] To the extent the statement of a single senator quoted by the Government (FERC Br., p. 25) is at all probative, that statement recognizes that section 318 is directed to "conflicts of jurisdiction," in order to prevent "duplication and overlapping," not only to circum-

Second, if the reach of section 318 were as limited as Petitioners contend, the section would be unnecessary. The 1935 Act contains *another* provision, section 21 of the PUHCA, which provides that "nothing in this chapter shall affect . . . the jurisdiction of any other commission . . . of the United States . . . over any person, security or contract, insofar as such jurisdiction *does not conflict* with any provision of this chapter or any rule, regulation or order thereunder." 15 U.S.C. § 79u (emphasis added). A similar savings provision in the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a), has been held, with respect to state regulation, to protect state authority by restating the Supremacy Clause, *see Leroy v. Great West. United Corp.*, 443 U.S. 173, 183 n.13 (1979), *i.e.*, to prohibit state regulation in circumstances of physical impossibility *or* when that regulation stands as an obstacle to the execution of the objectives of Congress in the manner specified by Congress. Section 318, which was intended to assure the primacy, and therefore the efficacy, of regulation under the PUHCA, surely cannot be read more narrowly than section 21, as Petitioners urge. Indeed, Congress declined to use section 21 (which was included in the original bills) as a drafting model when, in conference, it expanded section 318 to cover "any other subject matter," and thereby "enlarged [the scope of the section] to include *any* conflict arising under this bill." H.R. Rep. No. 1903, 74th Cong., 1st Sess. 75 (1935) (emphasis added).

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stances of impossibility or inconsistent requirements. Further, Petitioners' focus on whether it is possible at any given moment for an entity to comply with the dictates of both agencies would render the applicability of section 318 subject to constant change, in the absence of action by either agency, as the relationship between cost and market changes. Nothing in the language of section 318 suggests that the regulatory reach of the SEC and the FERC should fluctuate on a monthly basis with respect to the same transaction, or should vary between different transactions subject to the same statutory and regulatory requirements.

Limiting section 318 to instances of "physical impossibility," as Petitioners urge, in order to permit substitution of a market test for the cost standard Congress simultaneously reinserted in section 13(b), would be inconsistent with Congress' expansive purpose in modifying section 318.

Third, the "lower-of-cost-or-market" standard for which Petitioners contend does not appear in the 1935 Act. Indeed, such a standard was proposed, but Congress declined to adopt it for affiliate transactions.[23] Congress undoubtedly recognized that vertical integration could provide benefits not otherwise available, but that subjecting affiliate transactions within holding companies to such onerous requirements would amount to a *per se* rule against such transactions.[24] Congress decided against

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[23] The FTC recommended that Congress prohibit affiliate transactions within holding companies "at more than cost or at more than the open market rates, whichever is less." FTC Report, Part 73-a, p. 71. (A similar standard was also contained in an alternative proposal advanced by Representative Pettengill. *See* House Hearings, pp. 700-01.) The bills originally introduced in the House and the Senate appear to have carried out this recommendation, banning all transactions between a utility and its holding company affiliates, except with a mutual service company organized so as to ensure:

> performance of service, sales and/or construction contracts . . . for member companies (1) at cost fairly and equitably allocated among such member companies, and (2) at a substantial saving to member companies over the cost . . . of comparable contracts if performed by independent persons.

H.R. 5423, 74th Cong., 1st Sess. § 12(g) (1935); S. 1725, 74th Cong., 1st Sess. § 13(g) (1935). *See also* Message of President Roosevelt, quoted in H.R. Rep. No. 1318, 74th Cong., 1st Sess. 2 (1935). This standard was enacted in section 13(d), 15 U.S.C. § 79m(d), applicable to mutual service companies, but was discarded in favor of the "at cost" standard enacted in section 13(b) for other affiliate transactions.

[24] The SEC Staff has stated that a standard based on "the lower of cost or market would be an effective means of prohibiting captive

banning affiliate transactions, instead subjecting them to cost-based regulation by the SEC. In this manner, utility customers would receive the benefits of vertical integration by holding companies into businesses determined to be "economically necessary or appropriate" to the holding company's utility operations. 15 U.S.C. § 79k(b)(1).

Application of a lower-of-cost-or-market standard would be particularly inappropriate in this case. As the nation's largest single user of coal, which it utilized to provide reliable electric service to millions of customers, AEP was understandably concerned about the price and supply upheaval that rocked the coal markets in the late 1960's and the implications of the Clean Air Act amendments of 1970 for the availability of lower-sulfur coal. (R. 1534-36, 1664). To assure both a reliable supply of coal and price stability, AEP undertook an extensive effort to secure a portion of its coal supplies, capable of meeting one-third of its annual requirements, from mines subject to its control. Ohio Power's investment in Southern Ohio was part of this program and, like each such investment, required and received the approval of the SEC.[25] In reliance on the "at cost" standard of section 13(b), which assured that customers receive the benefits

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mines. It would make such investments improvident on their face . . . [which] avoid[s] the need to consider the claimed advantages of captive mines." Comments of the Division of Corporate Regulation of the Securities and Exchange Commission on the Federal Energy Regulatory Commission Staff Preliminary Report of Investigation in FERC Docket No. E-9206, Dated July 31, 1978 at 18 n. 15 (Oct. 27, 1978) ("SEC Staff Comments").

[25] *See supra* pp. 5-6 and *Ohio Power Co.*, Holding Company Act Release No. 22770 (Dec. 10, 1982); *Blackhawk Coal Co.*, Holding Company Act Release No. 21672 (Aug. 7, 1980); *Appalachian Power Co.*, Holding Company Act Release No. 18363 (Apr. 3, 1974); *Appalachian Power Co.*, Holding Company Act Release No. 17507 (Mar. 23, 1972); *Ohio Power Co.*, Holding Company Act Release No. 16932 (Dec. 14, 1970).

of the affiliated operation, Ohio Power invested over $57 million in the Martinka mine, and a total of $299 million in Southern Ohio. The FERC affirmed the findings of its ALJ, based on unrebutted evidence, that Ohio Power "was prudent in acquiring rights to the Martinka coal . . . that the Martinka mine has been efficiently developed and operated" (Jt. App., p. 69), and that the use of Martinka coal significantly improved the performance of an Ohio Power generating unit, which "justifie[d] paying about $12-$18 per ton more for a more suitable coal" (*id.*, p. 48-49).[26] Now, years after the investment has been made and the beneficial results achieved, Petitioners argue that, because it is not "physically impossible" for Ohio Power to recover a "market" price that is below cost, Ohio Power should be denied recovery of the cost-based price upon which the investment was premised. Nothing in section 318 or the 1935 Act as a whole supports such a result.

2. None of the precedents interpreting section 318 supports Petitioners' strained view that the statute applies only when compliance with both regulatory schemes was "physically impossible" at the time the agencies' orders were issued.

The only previous time the interplay between the FPA and the PUHCA was before this Court was in *Northwestern Electric Co. v. FPC*, 321 U.S. 119 (1944), where a utility subsidiary of a holding company challenged the authority of the FPC to prescribe and apply to it a system of accounts, arguing, *inter alia*, that the regulation was "in conflict with the powers and the regulation of the Securities and Exchange Commission." *Id.* at 125. The Court rejected this contention, without citing section 318. The Court's discussion, in its entirety, was as follows: "[A]n examination of the statute and of the or-

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[26] The FERC's order stated that the ALJ's decision "is affirmed and adopted to the extent it is not inconsistent with this Opinion." (Pet. App., p. 65a.)

ders and proceedings of the Securities and Exchange Commission satisfies us that no conflict exists." *Id.* As the FERC notes (Br. at 15), a letter from the Chairman of the SEC was appended to the Government's brief in *Northwestern Electric.* The letter explained that some provisions of the PUHCA are not self-executing, and:

> Until the S.E.C. does by rule or order impose "requirements" pursuant to the sections which are not self-operative, there can be no conflict of requirements and Sec. 318 does not apply. It was not intended that utility companies should be able to thwart regulation by the F.P.C. by conjuring up . . . conflicts with *potential* action of the S.E.C.

Resp. Br. App. D at 98-99, *Northwestern Elec. Co. v. FPC*, 321 U.S. 119 (1944) (emphasis in original). Significantly, the letter did not include section 13(b) in the list of sections of the PUHCA that are not self-operative. *Id.* at 99.

By specifying that the possibility of "*potential* action" imposing a requirement was insufficient to implicate section 318, the SEC was acknowledging that the appropriate inquiry was whether the SEC has actually imposed requirements applicable to the subject matter at issue (or whether Congress has done so with respect to self-executing provisions). The SEC based its view that section 318 was inapplicable on the fact that its Rule U-27 (17 C.F.R. § 250.27 (1941)) adopted the FPC's accounting system for electric companies not already subject to it. *Id.* at 99-100. In its brief, the Government also noted that the SEC's Rule U-26 (17 C.F.R. § 250.26 (1941)) exempted utilities subject to the FPC's accounting system from the SEC's uniform system of accounts. *Id.* at 59 n.44. The SEC also considered it important to emphasize that the FPC's action at issue, requiring the utility to make a correction to its earned surplus account, was "fully consistent" with the purpose of the SEC's regulation under section 12(c) of the PUHCA: "to protect financial integrity and to prevent payment of dividends

out of capital or unearned surplus." *Id.* at 104. The SEC thus found section 318 inapplicable by determining that neither the PUHCA nor the SEC's rules had imposed a requirement with respect to the subject matter at issue, a conclusion buttressed by the fact that the requirement imposed by the FPC was compatible with "the accomplishment and execution of the full purposes and objectives of Congress." *Pacific Gas & Electric*, 461 U.S. at 204.

Appalachian Power Co. v. FPC, 328 F.2d 237 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964), also involved an accounting issue. The court noted that, under Rules U-26 and U-27, the SEC "does not require utilities to keep their books in accordance with its requirements," and, indeed, "explicitly excepted" utilities from its uniform system of accounts under the PUHCA. *Id.* at 250. The court determined that the purpose of the SEC's accounting regulation under the PUHCA was to ensure that "the financial statements filed with it be prepared in a manner which provides adequate and fair disclosure." *Id.* at 250-51, quoting Accounting Series, Release No. 85 (Holding Company Act, Release No. 14173) (1960). The court found no "incompatibility" between this purpose and the FPC's requirement that its accounts—which had been adopted by the SEC—be used in the company's public financial reports. *Id.* at 252.[27]

The analysis undertaken by the Court of Appeals in this case was entirely consistent with those in *Northwestern Electric* and *Appalachian Power.* The court

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[27] The FERC (Br. at 27 n. 14) also relies upon *Mississippi Industries v. FERC*, 808 F.2d 1525, 1550, *reh'g granted and vacated in part on other grounds*, 822 F.2d 1104 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987). This reliance is misplaced. As the court below correctly recognized (Pet. App., p. 13a), section 318 was inapplicable in *Mississippi Industries* by its terms because the contract at issue concerned the sale of electric energy, which is, by definition, excluded from any "requirement" under the PUHCA. 15 U.S.C. § 79b(a)(20).

reached a different result because it found it "unquestioned" that Ohio Power is subject to requirements promulgated under the PUHCA with respect to the purchase of coal from Southern Ohio (Pet. App., p. 5a) and it determined that the FERC's application of market test cannot be reconciled with the SEC's concurrent application of a cost standard. The court's conclusion that an actual conflict was not a prerequisite to the application of section 318 (Pet. App., p. 14a) does not suggest any lack of allegiance to *Northwestern Electric* and *Appalachian Power*. Since the only "actual conflict" argument presented to the court was based on "[t]he fact that the FERC's market approach produces a current result that does 'not exceed' cost," a fact the court correctly found immaterial (*id.*), the court was simply rejecting the "physical impossibility" requirement, which cannot be found in the earlier cases.

3. Petitioners acknowledge (Br., p. 44) that interpreting section 318 to apply only in the cases where it is "physically impossible" to comply with the requirements of the FERC and the SEC inevitably creates a situation in which a portion of the price that Ohio Power is required to pay to Southern Ohio, under the contract and the SEC's orders and regulations, is "trapped" by virtue of the FERC's denial of rate recovery. The Court of Appeals recognized that this Court's decisions in *Nantahala*, 476 U.S. at 970-71, and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), "disfavor conflicting regulation resulting in trapped costs." (Pet. App., p. 16a-17a.) Though Petitioners and the FERC argue that these cases are inapposite because they involved instances in which Congress had "preempted the field" of regulation of wholesale electric rates, the analyses in these cases did not rest on that ground.

The Court did *not* hold in either *Mississippi Power & Light* or *Nantahala* that Congress' occupation of the field of wholesale electric rate regulation precluded the states

from exercising any authority over the manner in which costs incurred in wholesale transactions were reflected in retail rates. *See Nantahala*, 476 U.S. at 967-68.[28] Rather, the Court held that if a state's "undoubted jurisdiction over retail sales" were deemed to empower it to reexamine issues underlying wholesale rates fixed by the FERC, "impermissible interference . . . with the scheme of federal regulation" would result. *Id.* at 970. In both cases, the Court found that "[a] state must . . . give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority." *Mississippi Power & Light*, 478 U.S. at 373, quoting *Nantahala*, 476 U.S. at 966.

The implications of this analysis for this case are clear. The FERC's "undoubted jurisdiction" over wholesale rates does not empower it to redetermine the appropriate pricing of the transaction between Ohio Power and Southern Ohio, requiring Ohio Power to "pretend that it is paying less for the [coal] it receives from [Southern Ohio], under agreements not subject to [the FERC's] jurisdiction, than is in fact the case." *Nantahala*, 476 U.S. at 971. Its attempt to subject this transaction to an inconsistent standard constitutes "impermissible interference . . . with the scheme of federal regulation" under the PUHCA (*id.* at 970), and fails to "give effect to Congress' desire to give [the SEC] plenary authority over . . . [transactions between holding company affiliates and] interfere[s] with this authority." *Mississippi Power & Light*, 487 U.S. at 373. The SEC's enforcement of the

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[28] Counsel for Petitioners here, representing the Appellant in *Mississippi Power & Light*, explained, "Under *Nantahala*, state ratemaking authority is preempted in only one limited respect. . . . [T]he state commission retains plenary authority to determine all other components of retail revenue requirements[,] . . . to design the specific rates under which the utility may recover its revenue requirements and to determine the manner and time frame in which extraordinary expenses will be recovered." Appellant's Reply Br., pp. 1-2.

congressional determination that consumers and the public interest are best protected by application of a cost standard to affiliate transactions within holding companies would be frustrated if the FERC were free to apply a different standard to these transactions. There is therefore an unmistakable conflict between the FERC's orders in this case and the requirements imposed by the SEC under section 13(b).

The fallacy in Petitioners' attempt to read a current "physical impossibility" requirement into section 318 is also apparent from the Court's recent decision in *California v. FERC*. There the Court held that a state's attempt to specify a higher minimum flow rate for a hydroelectric dam than was required by the license issued by the FERC was preempted. Even though it would not have been "physically impossible" for the licensee to comply with both minimum flow requirements (by simply meeting the higher state minimum requirement), the Court stated, "[a]llowing California to impose significantly higher minimum stream flow requirements would disturb and conflict with the balance embodied in" the FERC's licensing decision. 58 U.S.L.W. at 4595. The state provision thus stood "as an obstacle to the accomplishment of the full purposes and objectives of Congress." *Id.*, quoting, *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1984). The Court also noted that hydroelectric licensees had "considerable reliance interests" in the long-standing interpretation of the regulatory scheme. *Id.* at 4594.

Here, too, allowing the FERC to limit recovery to a market-based price because there is "room" below the cost-based price mandated by the SEC (viewed as a ceiling) would defeat the balance between the interests of consumers and investors that is reflected in section 13(b) and the implementing SEC regulations, amounting to precisely the type of "bleeding" of a utility subsidiary of

a holding company that Petitioners acknowledge (Br., p. 31 n.12) was of concern to Congress. *See* 15 U.S.C. § 79a(b)(1). Ohio Power's investment of over $299 million in Southern Ohio, approved by the SEC beginning almost twenty years ago, in order to provide reliable coal supplies for key generating units, surely represents a "considerable reliance interest" no less worthy of protection.

Even if Ohio Power were somehow able to retain the excess when market exceeds cost, the FERC's imposition of a market test would still fly in the face of Congress' decision that, through the cost standard, customers should receive those benefits. Section 11 of the PUHCA makes it apparent that Congress intended the decision as to whether a holding company will be permitted to enter a non-utility business to turn on whether the transaction was expected to produce benefits for the system's utility customers, *i.e.*, to be "economically necessary or appropriate" to the system's utility operations. 15 U.S.C. § 79k(b)(1). The FERC's market test would instead turn the decision into one based on the holding company's likelihood of realizing profits. An interpretation of section 318 that permits the FERC to undermine the basis of regulation under the PUHCA in this manner is plainly contrary to the statute.

D. The Decision Below Does Not Create a Regulatory Gap.

Petitioners and the Government argue that affirmance of the decision below necessarily would create a "regulatory gap" of significant proportion, in contravention of the comprehensive regulatory scheme intended by enactment of the Public Utility Act of 1935. Their parade of horrors (Pet. Br., pp. 32-34; FERC Br., pp. 26-27, 34-35) is misplaced. It proceeds from their mistaken assumption that the decision below is grounded on broad "field preemption" principles and from a misunderstanding of both the PUHCA and the FPA.

1. Nothing in the decision below restricts the authority of the FERC to regulate subject matters as to which neither the PUHCA nor the SEC's regulations and orders thereunder impose a requirement. The Court of Appeals' analysis was *not* premised upon the existence of "authority to regulate, even if unexercised" (Pet. Br., p. 24), but upon the requirements actually imposed by the statute and by the SEC's rules and orders.[29] Its conclusion that the FERC and the SEC were addressing the same subject matter and its finding that the FERC's order could not be reconciled with the "bar" explicit in the SEC's rules and orders led the court to find that the FERC had overstepped its bounds. The "early" agency decisions relied upon by the Government do not advance its cause. In *In re Evans*, 1 F.P.C. 511 (1937), the Federal Power Commission observed that "[a]s a result of the operation of section 318 of the Act [it] *is excluded* from jurisdiction over certain phases of the reorganization" (*id.* at 515; emphasis added), suggesting that the FPC considered itself ousted of even "concurrent, consistent" regulation over the aspects of the transaction regulated by the SEC. But as to those matters not subject to SEC-imposed requirements, the FPC exercised its regulatory discretion. *Id.* at 516-517. *In re Olcott Falls Co.*, 3 F.P.C. 310 (1942), is precisely to the same effect. The FPC recognized its ability to fill the gaps left unregulated by the SEC. What it declined to pass on, however, was the appropriateness of an acquisition of utility assets, which, if subject to the SEC's review under PUHCA, would be "exempt from the requirements of section 203 of the Federal Power Act by section 318 of that Act." Indeed, the FPC made clear that "in the first instance" the question of whether the acquisition was subject to a requirement under the

[29] As the letter of the SEC Chairman introduced in *Northwestern Electric* makes clear, a "requirement" may be imposed by the PUHCA itself, as well as by the SEC's rules or orders.

PUHCA relates to "the applicability of provisions of the Holding Company Act, and we therefore express no opinion on it pending a decision by the Securities and Exchange Commission which is charged with the administration of that Act." *Id.* at 312. Finally, the failure of the "regulatory gap" contention is manifest from the Government's discussion of *Appalachian Electric Power Co.*, 27 S.E.C. 1029 (1948), where the SEC indicated that the FPC was free to regulate the "consequences" of the approval that the SEC had given—that is, to regulate the terms of the sale of power from a generating company the formation of which the SEC had authorized—subject to the SEC retaining the prerogative of ensuring consistency with the requirements of PUHCA.

2. There is absolutely no basis for concern that utilities within holding company structures will be free to integrate vertically into non-utility areas without regulatory scrutiny. The PUHCA gives the SEC plenary authority over a holding company's expansion into a non-utility business, by virtue of section 9(a)(1). 15 U.S.C. § 79i(a)(1). An acquisition of an interest in any business is not to be approved if it "will tend towards interlocking relations or the concentration of control of public utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers," 15 U.S.C. § 79j(b)(1), or if the business is not "reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system." 15 U.S.C. § 79k(b)(1).[30]

[30] The SEC has developed a "functional relationship" test to implement this standard. *See Michigan Consol. Gas Co. v. SEC*, 444 F.2d 913, 916 (D.C. Cir. 1971). One factor considered under this test is whether an affiliate transaction would provide a benefit not available through transactions with third parties. *See Public Serv. Co. of Oklahoma*, 45 S.E.C. 878, 884 (1975) (approving investment in oil and gas exploration venture as a means of meeting fuel requirements "when traditional purchases under long-term contracts are unavailable or are subject to curtailments or interruption").

It was pursuant to, and in total conformance with, this statutory structure that the Ohio Power-Southern Ohio relationship was forged. In fact, as noted *supra* p. 32 and n. 25, all of AEP's affiliated fuel supply operations were subject to SEC review and approval. Plainly, no "regulatory gap" exists.

3. Neither the FERC's ability to determine wholesale rates, nor its ability to pass on the disposition of utility assets, nor its ability to regulate accounting matters, is called into question by the decision below.

First, under *Appalachian Electric Power Co.*, although the SEC has authorized a transaction, the FERC remains free to regulate the consequences of the transaction for wholesale rates, provided that in so doing it does not do violence to requirements imposed by the SEC pursuant to the PUHCA. The FERC's proper role under the 1935 Act is to decide, in setting wholesale rates, *how* to apply determinations of the SEC, made pursuant to the PUHCA, but *not* to disregard those determinations.[31] In addition to assuring that a utility does not recover in rates an amount greater than cost, determined as specified by the SEC, and determining the manner in which that cost will be reflected in rates, the FERC may also integrate the pricing formula fixed by the SEC with the other considerations affecting the overall level of rates. *Cf. Nantahala*, 476 U.S. at 967-68. The FERC may even intervene before the SEC to urge the SEC to exercise its authority under section 13(b) to grant exemptions from the cost standard in an appropriate case. That the FERC may not, in addition, refuse to apply the "at cost"

[31] The division of the SEC Staff responsible for enforcement of the PUHCA has explained that "[t]he SEC pricing orders are final orders directed . . . to fixing a pricing formula," but the rate-making authority "has jurisdiction to try issues, both of fact and of interpretation, in *applying* such orders, insofar as material, to a particular rate case." SEC Staff Comments at 3 (emphasis added) (R. 7916).

standard mandated by section 13(b) of the PUHCA to a transaction unquestionably subject to that provision, does not demonstrate the existence of a regulatory gap.

Second, the decision below has no effect on the FERC's authority over utility divestitures. As the FPC recognized in *In re Olcott Falls*, section 318 is inapplicable in that situation because different "persons" are involved—the SEC has jurisdiction over the acquirer, the FERC over the entity disposing of utility assets (unless the SEC also has jurisdiction over that entity under section 12(d) of the PUHCA, 15 U.S.C. § 79*l*(d)).[32] In fact, in both *In re Olcott Falls* and *In re Evans*, the FPC passed on the appropriateness of a disposition under section 203 of the FPA, 16 U.S.C. § 824b.

Finally, the FERC's comprehensive authority to regulate the books of account of public utilities, 16 U.S.C. § 825(a), is not threatened by the decision below, which, like the decisions in *Northwestern Electric* and *Appalachian Power*, focused on the requirements, if any, imposed by the SEC. The FERC accounting authority, indeed, is assured by section 20(b) of PUHCA, 15 U.S.C. § 79t(b). In that section Congress, although giving the SEC a role in prescribing accounting standards for holding companies, prohibited accounting requirements by the SEC that are "inconsistent" with those "prescribed under the provisions of any law of the United States." The SEC has recognized the force of this prohibition and from the outset has directed companies subject to the

[32] *Amicus* American Public Power Ass'n argues (Br., p. 8) that, under the same analysis, section 13(b) applies only to the seller in an inter-affiliate transaction, not to the utility buyer, and so section 318 is inapplicable. The flaw in this argument (which does not appear in the FERC's orders) is that section 13(b) only applies when both the buyer and the seller are affiliates within the same holding company. The buyer is necessarily subject to the requirements of section 13(b), which *must* be the case if the manifest purpose of the provision—to protect utility subsidiaries of holding companies and their customers from exploitation—is to be served.

PUHCA to keep their books of account "in the manner currently prescribed for similar companies by the Federal Power Commission." 17 C.F.R. § 250.27(a) (1989). Indeed, that is precisely the rationale that underlies *Northwestern Electric* and *Appalachian Power*.

Thus, the bond of regulatory protection is complete. If the PUHCA or the SEC's rules or orders do not impose a requirement with respect to any subject matter and the FERC would otherwise be authorized to act, the FERC may do so. What the FERC may not do is what it attempted to do here: substitute its policy judgment for that of the SEC with respect to matters that Congress has delegated to the latter. In the final analysis, Petitioners' complaint appears to be addressed more to their dissatisfaction with the nature of SEC regulation—indeed, with section 13(b) itself. As to that, however, the court below correctly found (Pet. App., p. 11a) that their petition must be addressed to Congress. *See Board of Governors v. Dimension Fin. Corp.*, 474 U.S. 361, 373-74 (1986).

III. IF IT IS NECESSARY TO REACH THE OTHER FLAWS IN THE FERC'S DECISION, THE CASE SHOULD BE REMANDED TO THE COURT OF APPEALS.

The concurring member of the panel below found that, wholly apart from section 318, the FERC's decision violated the plain language of the agency's own regulation, 18 C.F.R. § 35.14(a)(7) (1989), which provides that, where the price of fuel purchased by a utility from an affiliate "is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and includable" in wholesale rates. (Pet. App., p. 28a.) Petitioners argue (Br. at 44-45) that the concurring judge erred in concluding that the phrase "shall be deemed" cannot be interpreted to create only a rebuttable presumption of reasonableness, rather than a conclusive

presumption. (Pet. App., pp. 24a-25a.)[33] They contend that several courts, including this Court, have construed the same phrase to create only a rebuttable presumption.

We are compelled to point out that Petitioners' reliance on *Lavine v. Milne*, 424 U.S. 577 (1976), for this proposition is based on an incomplete reading of the state law at issue in that case. Petitioners assert that the statute provided that a person who applies for welfare assistance within 75 days after voluntarily terminating his employment "shall be 'deemed' to have done so . . . for the purpose of qualifying for such assistance . . ." (Pet. Br., p. 45, quoting 18 N.Y. Soc. Serv. Law § 131 (11) (Supp. 1975); final ellipses in Pet. Br.) They fail to note, however, that this sentence goes on to provide that the applicant shall be deemed to have terminated his employment for the stated purpose "in the absence of evidence to the contrary supplied by such person." 18 N.Y. Soc. Serv. Law § 131(11) (Supp. 1975), quoted in *Lavine v. Milne*, 424 U.S. at 579. The Court's conclusion that this statute merely clarifies the assignment of the burden of proof to the applicant for assistance, 424 U.S. at 584, is unremarkable in light of the complete language of the statute. Since, however, the FERC's regulation at issue contains no counterpart to the "in the absence of evidence to the contrary" language in the New York statute, the decision in *Lavine v. Milne* has no bearing on this case.[34]

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[33] The concurring judge held that no deference was owed to the FERC's interpretation of the regulation because it was "at odds with the plain meaning of the text." (Pet. App., p. 24a.) He also held that "courts construing the word 'deemed' have generally found that it establishes a conclusive presumption." (*Id.*, citations omitted).

[34] The other federal decisions relied upon by Petitioners offer no more support for their claim. First, the statute at issue in *Hardy v. Lomenzo*, 349 F. Supp. 617, 621 (S.D.N.Y. 1972), like that in *Lavine v. Milne*, provided expressly for the introduction of evidence on the point ultimately at issue, a provision that cannot be found

The panel majority had no occasion to consider whether the FERC's decision violated the terms of its regulation because it found section 318 dispositive. (Pet. App., p. 19a.) No member of the court below reached Ohio Power's argument that the FERC's decision was arbitrary and capricious in that it compared the price Ohio Power paid for coal under its contract with Southern Ohio to a "comparable market" construct that was deficient in numerous respects. As an example, the FERC calculated its market comparison price by including coal with a substantially higher sulfur content than the Southern Ohio coal (up to 4% sulfur, when Southern Ohio coal averaged 1.5% sulfur), as well as coal of the type that had caused operating inefficiencies at the Ohio Power generating unit, which were remedied by the Southern Ohio coal. (Pet. App., p. 46a; Jt. App., pp. 47-48.) It is only through this manipulation of the "comparable market" that the FERC was able to find the cost-based price of Southern Ohio coal excessive.

Since these contentions were not considered below, if it is necessary to reach them this case should be remanded to the Court of Appeals for that purpose. *See Patrick v. Burget*, 486 U.S. 94, 99 n. 5 (1988); *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 568 (1981).

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in the FERC's regulation. *Gaither v. Myers*, 404 F.2d 216, 218 (D.C. Cir. 1968), did *not* hold that statutory language providing that any person operating a vehicle "with the consent of the owner, express or implied . . . shall . . . be deemed to be the agent of the owner" creates a rebuttable presumption. This language, the court stated, "provides a new substantive rule of law." *Id.* at 219. *Another* clause in the statute, providing that ownership of a vehicle involved in an accident "shall be *prima facie* evidence" that the driver has the consent of the owner, was held to establish a rebuttable presumption to that effect. *Id.* at 218. In *Bowers v. United States*, 226 F.2d 424, 428 (5th Cir. 1955), the majority found that the phrase "shall be deemed" was intended to operate not merely as a "presumption of fact rebuttable or otherwise, but as the [conclusive] statement of a substantive rule of law."

CONCLUSION

For the foregoing reasons, the decision of the United States Court of Appeals for the District of Columbia Circuit should be affirmed.

Respectfully submitted,

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No. 89-1283

In the Supreme Court of the United States

OCTOBER TERM, 1990

ARCADIA, OHIO, ET AL., PETITIONERS

v.

OHIO POWER COMPANY, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION[1]

In enacting the Public Utility Act of 1935, Congress put in place a regulatory scheme in which both the Federal Energy Regulatory Commission and the Securities and Exchange Commission were entrusted with responsibility to regulate utility subsidiaries of public utility holding companies. Both FERC and the SEC have long understood Section 318 of the Federal Power Act (FPA), 16 U.S.C. 825q, to require an actual conflict between FERC and SEC re-

[1] This reply brief is submitted on behalf of the Federal Energy Regulatory Commission (FERC), a respondent supporting petitioners in this case. See Sup. Ct. R. 12.4. The Securities and Exchange Commission (SEC) joined FERC in the opening brief as an amicus curiae. Because the SEC is not a party to this case, this Court's Rules do not authorize it to submit a reply brief. See Sup. Ct. R. 37.3. The SEC is, however, in agreement with the views expressed in this brief.

quirements before giving precedence to the latter, thus permitting each agency to pursue its differing regulatory objectives. This understanding reflects the experience of the agencies in administering the FPA and the Public Utility Holding Company Act (PUHCA) and, as an interpretation of a statute by agencies charged with administering it, is entitled to *Chevron* deference.

1. As an initial matter, Ohio Power contends that no deference is due to the construction of Section 318 by FERC and the SEC, since that construction is claimed not to have been relied upon by FERC in the order at issue in this case. See Ohio Power Br. 13. Ohio Power is mistaken. In its order in this case, FERC began its discussion of Section 318 with a description of the administrative law judge's conclusion that FERC action would not subject "the same subject matter * * * to the requirements of both PUHCA and the Federal Power Act." Pet. App. 36a. FERC proceeded to advance *two* reasons for agreeing with this conclusion.

The first ground adduced by FERC is precisely the "actual conflict" interpretation that was plainly raised in the second question presented in the petition for certiorari.[2] FERC noted that "it is not clear that the SEC requires Ohio Power to purchase coal from its subsidiary at cost, rather than at market price." Pet. App. 36a. The SEC orders in this case, according to FERC, "do not appear to mandate the cost-based price where a market price would be lower, rather they permit a price up to a cost-based price." *Ibid.* FERC went on to add that, in its view, SEC Rule 92, 17 C.F.R. 250.92, permits the sale of goods produced by a

[2] Nothing in Ohio Power's brief in opposition to the petition for certiorari suggested that the second question presented in the petition—"[w]hether Section 318 * * * oust[s] the [FERC] of jurisdiction over rate matters only when there is an actual conflict" between PUHCA-based and FPA-based regulation—is not squarely before the Court in this case. See Sup. Ct. R. 15.1.

holding company subsidiary to any associated company at a market price "if the market price is lower than cost." Pet. App. 36a-37a.

Thus, the FERC order under review plainly advanced the argument that the SEC orders and rules relevant to this case permit a market-based price, so long as that price is lower than cost. Although FERC may not have articulated all of the implications of this argument as Ohio Power would prefer, the underlying premise is clear; in FERC's view, its action permitting a market price in this case was permissible because it did not conflict with SEC regulation of the Ohio Power-SOCCO transaction under PUHCA.[3] The court of appeals expressly recognized that "FERC's statutory interpretation rested on two rationales: (1) that there is no conflict between the approaches of the SEC and FERC and (2) that the same subject matter is not involved." Pet. App. 8a.[4] See also Pet. App. 14a ("FERC's first-stated * * * rationale was that no jurisdictional conflict arises because the SEC *may* require market pricing and 'it is not clear' that the SEC's orders in the present case impose a cost floor as well as a cost ceiling." (citation omitted)).

FERC did advance another ground for its decision: that ratemaking was a distinct "subject matter" from the SEC's

[3] For this reason, the cases cited by Ohio Power (Br. 15) are inapposite. In those cases, see *Bowen* v. *Georgetown Univ. Hosp.*, 109 S. Ct. 468, 473 (1988); *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 397 (1974); *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 628 (1971); *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168 (1962), the Court held that an administrative order could not be upheld on the basis of a rationale that was adopted for the first time as a litigation position and was not in the agency's order at all. In contrast, here the FERC order discussed and adopted the no actual conflict rationale as an alternative ground for its decision.

[4] We do not here address whether the SEC and FERC orders are in actual conflict. At pp. 10-12, *infra*, we suggest remand for the court of appeals to address that issue in light of the "actual conflict" standard in the first instance.

regulation under PUHCA Section 13(b), 15 U.S.C. 79m(b), of intra-corporate transfer prices for coal, and that FERC therefore could—consistent with Section 318—require Ohio Power to use a market price for the coal for ratemaking purposes even if that price exceeded the cost of the coal. See Pet. App. 37a-40a, 60a-64a.[5] The fact that FERC relied on an alternative ground to support the order under review does not affect the deference due to FERC's interpretation of Section 318 as requiring an actual conflict. This is particularly true since, as we discussed in our opening brief, FERC's understanding that Section 318 requires an actual conflict has its roots in an interpretation of Section 318 relied upon by FERC, its predecessor the Federal Power Commission, and the SEC that dates back to shortly after the statute was enacted and that FERC has continued to rely on in more recent cases. See FERC & SEC Br. 15-21.

2. Ohio Power contends, as did the court of appeals majority, that Section 318's bar to FERC jurisdiction is triggered whenever the SEC, without more, has regulated a given subject matter. Ohio Power Br. 18.[6] As we discussed in our opening brief (at 21-27), this view is in tension

[5] The court of appeals considered—and rejected—this rationale in a discussion separate from its discussion of FERC's no actual conflict rationale. See Pet. App. 10a-13a.

[6] Ohio Power pays lip service to the term "requirement" in Section 318, by acknowledging that it must be shown that the SEC has imposed a "requirement" with respect to a given subject matter before FERC is ousted of jurisdiction with respect to that subject matter. Ohio Power Br. 18. However, as Ohio Power's immediately succeeding discussion makes clear, it believes that *any* SEC regulation counts as a "requirement," and thereby ousts FERC from jurisdiction over the entire "subject matter." *Id.* at 18-19. In fact, a regulation that, for example, merely permits a regulated entity to engage in a particular activity would not impose a "requirement" and such a regulation would not oust FERC of jurisdiction to impose its own regulation.

with the language of the statute and with the few judicial decisions interpreting Section 318, all of which have determined the application of Section 318 by inquiring whether the challenged FERC (or FPC) action was in conflict with SEC regulation under PUHCA.[7] Moreover, Ohio Power's own discussion and that of its amici illustrate an additional, and important, difficulty.

Ohio Power and its amici contend that interpreting Section 318 to oust FERC of jurisdiction whenever the SEC has taken any regulatory action with respect to a given "subject matter" would invalidate FERC's adoption of a market-based price in this case, while not opening up any gaps in the comprehensive system of utility regulation pursuant to PUHCA and the FPA. For example, Ohio Power contends (Br. 40-41) that the long history of concurrent, consistent FERC/FPC and SEC regulation of purchases and sales of utility assets (discussed in our opening brief at (31-35)) is permissible under Section 318. It is argued that, although the SEC undeniably had authority to, and in fact did, regulate some aspects of the transactions (generally the purchase side, see PUHCA §§ 9 and 10, 15 U.S.C. 79i, 79j), that regulation did not impose requirements with respect to those aspects of the transaction regulated by FERC (generally the sale side, see FPA § 203, 16 U.S.C. 824b).

This argument can be understood in either of two ways. It may be that Ohio Power is here urging that concurrent

[7] Amici Registered Holding Company Group cites an SEC submission to the Conference Committee that produced the final version of the Public Utility Act as support for the view that Section 318 was intended to prohibit even consistent, concurrent regulation by FERC and the SEC. Holding Company Group Amici Br. 15-16. The report of the Conference Committee itself, however, made clear that it viewed Section 318 as a conflict-preemption provision (see FERC & SEC Br. 23-25), and both FERC and the SEC have adhered to that view since then. See *id.* at 14-19.

SEC/FERC regulation of a purchase and sale transaction is permissible because the SEC regulation of the purchase side of the transaction does not conflict with the FERC regulation of the sale side. If so, Ohio Power is relying on the "actual conflict" interpretation of Section 318 that we have proposed, and that we believe to be the only interpretation that supplies a workable standard for allocating jurisdiction between the two agencies.

Alternatively, Ohio Power could be arguing that the purchase and sale sides of the transaction are different "subject matters," and Section 318 thus has no application. Ohio Power, however, offers no justification for this conclusion. Indeed, with respect to each of these transactions, the purchase side can be characterized as a different "subject matter" from the sale side, or both purchase and sale can be seen as involving the same "subject matter"—the transfer of a utility asset. Similarly, as FERC itself contended, the regulation of rates can be seen as a different "subject matter" from the intra-corporate transfer price of coal, or both FERC and the SEC can be seen as regulating the same "subject matter"—the price of coal used by Ohio Power in generating electricity.

The above examples can be replicated with respect to many applications of Section 318. If the crucial determination under the statute is simply whether FERC and the SEC are regulating different "subject matters," the characterization of what "subject matter" is involved in a given regulatory action becomes all-important. Neither Ohio Power nor its amici offer any assistance in determining whether one or two subject matters are involved in the purchase and sale of a single utility asset—or in the setting of rates and the regulation of the intra-corporate transfer price of coal, or in any other possible area of contention under Section 318. In short, characterizing the "subject matter" involved in a given regulation is, in the absence of any suggestion as to the governing standards, a manipulable exercise.

If Ohio Power is right, the courts would have to devise a way to determine which subject matters were involved in a given case, with no guidance from the statute. A provision that read along these lines would be difficult to square with Congress's understanding that the SEC's expertise and regulatory objectives were centered in the area of finanical abuses and controls (see FERC & SEC Br. 28) while those of FERC centered on operational issues and ratemaking with respect to the interstate utility industry. See *id.* at 29. Such an amorphous approach would, moreover, be in tension with Congress's intent in PUHCA to preserve nonconflicting regulation by other federal and state agencies, see PUHCA §§ 20(b) and 21, 15 U.S.C. 79t(b), 79u, rather than to allocate all regulatory authority over utility holding companies and their subsidiaries to the SEC. See FERC & SEC Br. 22-23.

Section 318's bar, however, is not triggered simply by a determination of whether the same "subject matter" is involved in SEC and FERC regulation. Rather, it is triggered when "requirements" are imposed under both PUHCA and the FPA.[8] When a regulated entity is "required" by the SEC to undertake—or not to undertake—a particular action, any FERC regulation that imposes a different "requirement" with respect to that same subject matter is invalid. In other words, as the references to "conflict" in the heading of Section 318 and (repeatedly) in the legislative history (see FERC

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[8] Ohio Power mischaracterizes our position in asserting that we claim that it is "irrelevant" whether the subject matters of FERC and SEC regulation are the same. See Ohio Power Br. 19 n.12. The comment in our brief to which Ohio Power refers (Br. 35 n. 23) stated that the precise definition of "subject matter" will ordinarily be unnecessary, since the actual conflict analysis that we propose takes into account whether the same or different subject matters are involved; if there is an actual conflict of "requirements," the same subject matter is doubtless involved.

& SEC Br. 23-25) make clear, only when FPA-based regulation is in actual conflict with PUHCA-based regulation does Section 318's bar come into play. This standard provides a workable, pragmatic rule for allocating jurisdiction between the two agencies.

3. Ohio Power argues that the SEC has departed from an "actual conflict" understanding of Section 318, citing a statement that Chairman Shad presented to Congress in 1982, in which he advocated the repeal of PUHCA. See Ohio Power Br. 25. The statement notes that, in light of Section 318, "that portion of the industry represented by the registered holding company systems *is now subject to a different federal standard* for determining affiliate transaction prices than that applied to the rest of the industry." *Public Utility Holding Company Act: Hearings on H.R. 5220, H.R. 5465, and H.R. 6134 Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 97th Cong., 2d Sess. 582-583 (1982) (emphasis added).

Chairman Shad's statement, which mentioned this issue only in passing, does not support Ohio Power's position. Rather, the statement must be interpreted in light of the structure of holding company regulation. Utility subsidiaries of holding companies are subject to consistent, concurrent regulation under both PUHCA and the FPA. As a result of this dual regulation, they are necessarily subject to a *different* regulatory regime than are other firms in the utility industry; in the terms of this case, the Ohio Power-SOCCO transaction, unlike transactions among firms unrelated to holding companies, is subject *both* to regulations and orders under Section 13(b) of PUHCA *and* to non-conflicting regulations under the FPA. Because PUHCA-based regulation—not applicable at all to firms unaffiliated with holding companies—has primacy under Section 318 in cases of conflict, the regulations applied to holding company

affiliates may indeed be quite different from those applicable to firms that are not so affiliated.[9] As Chairman Shad recognized, if PUHCA were to be repealed, this difference would disappear.

In a similar vein, both Ohio Power (see Ohio Power Br. 34-35) and its amici (Amici Br. 19-20) attempt to explain the SEC's submission to this Court in *Northwestern Electric Co.* v. *FPC*, 321 U.S. 119 (1944), discussed in our opening brief (at 14-16). Neither Ohio Power nor its amici, however, can explain the SEC's repeated statements that "in case of *conflict* the requirements of [PUHCA] shall prevail," that "there can be no *conflict* of requirements and Sec. 318 does not apply" until the SEC or PUHCA has imposed regulation, and that regulation should not be thwarted by "conjuring up * * * imaginary *conflicts*."[10] Resp. Br. App. D, at 98-99, *Northwestern Electric Co.* v. *FPC*, *supra* (emphasis added). These statements make clear that the SEC, at least as early as 1944, believed that actual conflict between PUHCA-based and FPA-based requirements was necessary before Section 318 would act as a bar to FERC jurisdiction. It is this view that has guided both the SEC and FERC in pursuing their regulatory programs since that time, and it is this view that we urge should be adopted by the Court in this case.

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[9] Indeed, if Chairman Shad's statement were read the way Ohio Power suggests, it would have the incidental effect of rendering, *inter alia*, the SEC's own Rule 92 (see p. 11, *infra*), as well as the SEC's authority to grant exemptions under Section 13(b), a nullity.

[10] Nor do Ohio Power or its amici offer any explanation for the SEC's statements that, with respect to the issue in that case, "this exercise of accounting jurisdiction is not inconsistent with subsequent or concurrent accounting regulation of the same company by the F.P.C." and that "dual accounting regulation * * * has sound pragmatic justification, and is not inconsistent with the purpose of Sec. 318." Resp. Br. App. D, at 102. As we pointed out in our opening brief, this language plainly advances the view that concurrent, consistent—*i.e.*, non-conflicting—regulation by FERC and the SEC is permissible.

4. We continue to believe that a remand to the court of appeals is appropriate for a determination whether any requirement imposed by the four SEC orders in this case actually conflicts with FERC regulation. Section 13(b) of PUHCA, 15 U.S.C. 79m(b), renders certain transactions between associated companies unlawful:

> except in accordance with such terms and conditions and, subject to such limitations and prohibitions as the [SEC] by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies. This provision shall not apply to such transactions as the [SEC] by rules and regulations or order may conditionally or unconditionally exempt as being necessary or appropriate in the public interest or for the protection of investors or consumers, if such transactions * * * involve special or unusual circumstances or are not in the ordinary course of business.

This provision includes an authorization for the SEC to govern transactions between associated companies "by rules and regulations or order." In addition, it provides that SEC regulation is to be aimed at ensuring that such transactions be performed "economically and efficiently for the benefit of such associate companies at cost." Finally, Section 13(b) gives the SEC authority to exempt transactions, "by rules and regulations or order," under specified conditions.

Pursuant to the authority specifically granted in Section 13(b), the SEC issued a number of rules governing transactions between associated companies. Rule 90 prohibits such

transactions "at more than cost." 17 C.F.R. 250.90(a)(2).[11] Where a firm is selling goods it produced to an associated firm, the price is not "limited to cost." 17 C.F.R. 250.90(d). Instead, such goods must not be sold "at a price which exceeds the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere, or to furnish them itself, giving due regard to quality, quantity, regularity of supply, and other factors entering into the calculation of a fair price." 17 C.F.R. 250.92. In the absence of orders directed toward a specific transaction, these rules generally govern the price term of inter-associate contracts.

With respect to the particular relationship between Ohio Power and SOCCO, the SEC issued four orders. J.A. 76, 79, 85, 93. The first order provided that "[t]he charges for coal * * * will be based on an amount equal to the actual cost." J.A. 77. The three other orders stated that the price would "not exceed" cost. J.A. 82, 89, 94. The meaning of these orders is disputed. Compare Ohio Power Br. 27 n.21 with Pet. Br. 42, 44 n.29 and Pet. App. 21a-23a (Mikva, J., concurring in the judgment) and Pet. App. 35a-37a (FERC opinion).

Given its erroneous understanding of Section 318, the court of appeals had no occasion to construe the four SEC orders and the application, if any, of SEC Rules 90 and 92.[12]

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[11] Rule 90(a)(2), 17 C.F.R. 250.90(a)(2), specifies that cost is "determined pursuant to [Rule 91, 17 C.F.R.] 250.91 or any other applicable rule, regulation, or order of the Commission, or in the absence thereof, in accordance with sound methods of determining cost."

[12] Ohio Power is mistaken in claiming that the court of appeals found that the SEC orders had the effect of applying Rules 90 and 91 – mandating a cost-based price term for inter-affiliate contracts – to the transactions in question, rather than Rule 92, which provides for a market-based price. Br. 18 n.11. In fact, the court of appeals based its decision solely on "the threshold matter of the language of the

If the orders impose a strict at-cost requirement on Ohio Power's purchases of coal from SOCCO, they are in conflict with the FERC order in this case and Section 318 bars FERC jurisdiction. If, on the other hand, they impose only a cost-based ceiling on the price of coal or otherwise do not impose a requirement, the FERC order in this case may be in whole or part consistent with the SEC orders and regulations, and hence permissible under Section 318. The case should be remanded to the court of appeals for application of the actual conflict standard to the four SEC orders at issue in this case.[13]

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statute." Pet. App. 15a. The court referred to Rules 90 and 91 to make the point that the language concerning cost in the SEC orders may have been no more than "references in passing" to Ohio Power's "election of, and unexamined representations of conformity with, the Rule 91 at-cost method." Pet. App. 15a. Nothing in Rules 90, 91, or 92 suggests that a regulated entity may make an "election" as to which of the rules it chooses to comply with.

[13] Although the concurring member of the panel below (Pet. App. 23a-28a) found that FERC's order was invalid because it contravened one of FERC's own regulations, 18 C.F.R. 35.14(a)(7), the issue was not reached by the majority. Ohio Power has not argued in its opposition to the petition for certiorari or in its brief on the merits in this case that this Court should affirm the court of appeals' result on this ground. See Ohio Power Br. 44-45. As FERC has argued, its order in this case does not contravene 18 C.F.R. 35.14(a)(7). See FERC C.A. Pet. for Reh'g 12-14; FERC C.A. Br. 30-32; Pet. App. 40a-41a; J.A. 20-24.

For the foregoing reasons and those stated in our opening brief, it is respectfully submitted that the judgment of the court of appeals should be reversed.

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*Acting Solicitor General**

JULY 1990

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* The Solicitor General is disqualified in this case.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 89-1283

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF OF PETITIONERS

There are at least three fundamental errors in respondent's submission to this Court: 1) The court of appeals did not apply a conflict preemption analysis, but instead applied a field preemption analysis. 2) Congress did not create a regulatory scheme of limited SEC and FERC scrutiny of public utility holding companies in which imagined conflicts, based upon vague notions of "frustration of purpose," would be sufficient to undermine the FERC's ratemaking authority. 3) Nothing in Section 13(b) of PUHCA or the SEC's rules or orders imposes *any* requirement upon Ohio Power that is inconsistent with the FERC's rate order. Each of these errors warrants a brief discussion in reply.

I.

Respondent, which is interested primarily in winning this case, makes a concerted effort to have the case decided without regard to the clear holding of the court of appeals and the significant consequences to FERC ratemaking that flow from that holding. Thus, respondent denies that the court of appeals applied a "field preemption" analysis to interpret Section 318 as ousting FERC from any field in which the SEC may tread. Resp. Br. 16-17, 39. Respondent therefore does not dispute petitioners' argument that the panel's interpretation of the statute is contrary to the language, structure and legislative history of the entire Public Utility Act of 1935 (of which PUHCA and the FPA were the two principal components). Pet. Br. 17-35. Instead, respondent argues that the court of appeals's ruling was narrow and "carefully channeled" (Resp. Br. 17), and that it held only that Section 318 ousts FERC in this case because "the FERC's market-price test . . . is fundamentally incompatible with cost-based regulation of the Ohio Power-Southern Ohio transactions by the SEC." Resp. Br. 17.

By contrast, respondent's *amicus*, keenly interested in an unlimited opportunity for passing on inflated costs to electric customers, "unqualifiedly supports" the actual holding below, which deprives FERC of ratemaking authority whenever the SEC "has any jurisdiction" under a provision of PUHCA, such as Section 13(b). Brief of *Amicus Curiae* Registered Holding Company Group ("*Amicus* Brief") at 2-3.[1] *Amicus's* candor is as re-

[1] *Amicus* reads the term "requirement" out of Section 318. See Pet. Br. 18-20. By arguing that FERC loses its ratemaking authority whenever the SEC's latent jurisdiction can be invoked, *amicus* simply ignores the crucial restriction in the statute that there must be a requirement imposed by the SEC. It also fails to explain how its interpretation of Section 318 can be squared with the language in Section 204(f) of the FPA, which broadly restricts FERC's jurisdiction over any "security issues . . . regulated by a State Commission," 16 U.S.C. § 824c(f). Obviously, when Congress intended to implement a sweeping restriction upon the FERC's regulatory authority, it did so clearly and not with the type of limiting language used in Section 318.

freshing as its motives are suspicious. Its perception that the "field preemption" theory will free its members of a great deal of regulation by the FERC is unquestionably correct, and underscores the danger of the court of appeals's holding.

That court flatly rejected the argument that "the bar of section 318 applies only when there is a present conflict between SEC and FERC prescriptions." Pet. App. 14a. Instead, the court held that its decision rested "on the threshold matter of the language of [Section 318] which commits the determination of the inter-associate price to the SEC." *Id.* at 15a.[2] It is thus respondent, and not petitioners (see Resp. Br. 15), that has failed to defend the basis for the decision in its favor.[3] For the reasons explained in petitioners' opening brief

[2] As explained in petitioners' opening brief (at 18-19), the court of appeals's decision is ambiguous and can be read as relying upon either of two theories: (1) that Section 318 gives the SEC exclusive jurisdiction over all matters within its authority regardless of whether the SEC has exercised that authority; and (2) that Section 318 grants the SEC exclusive jurisdiction whenever the SEC has actually exercised some authority, however limited, over the "subject matter" at issue. Both approaches can properly be characterized as "field preemption," the only difference being how the "field" is defined.

[3] Petitioners have consistently defended the first-stated basis for the FERC's decision, *i.e.*, that the FERC was imposing no requirement upon respondent that was inconsistent with any requirement imposed by the SEC. See Pet. App. 37a-38a. Respondent simply ignores this alternative holding when it claims (Resp. Br. 13) that the FERC's decision did not rely upon the absence of an actual conflict, and when it therefore accuses petitioners and the Government of engaging in post hoc rationalization (Resp. Br. 14-15). Thus, for the reasons stated by the FERC in its reply brief (Br. 2-4), the suggestion of respondent (Resp. Br. 15-16 & n.10) that the petition should be dismissed as improvidently granted is without merit.

and in the briefs of the Solicitor General, the court of appeals's field preemption holding must be reversed.

II.

Respondent attempts to defend the holding of the court of appeals on the alternative ground that there is, in fact, a "conflict" between the SEC's and the FERC's regulatory requirements in this case. Respondent does not seriously dispute that there is no "actual conflict" here in the sense of inconsistent obligations.[4] Rather, it asserts that, directly or indirectly, "the SEC and the FERC were each seeking to regulate . . . the price to be paid to Ohio Power for coal." Resp. Br. 18.[5] According to respondent, this is sufficient to invoke Section 318 because that provision ousts FERC of its regulatory jurisdiction whenever a particular FERC order might "frustrate the purposes" of PUHCA or of an SEC regulation or order. Resp. Br. 28, 30. But this argument is misguided for exactly the same reasons that the court of appeals's "field preemption" theory was misguided: It distorts significantly the complementary, concurrent regulatory schemes established by Congress, as reflected in the language, structure and legislative history of the FPA and PUHCA. See Pet. Br. 17-35.

In interpreting Section 318, it is important to remember that one of the principal purposes of the entire Pub-

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[4] Respondent does suggest that Section 13(b) of PUHCA prevents it from collecting from its ratepayers anything more or less than SOCCO's "cost." See Resp. Br. 21, 27 n.21. But that argument is without substance. See *infra* 9-13.

[5] Respondent falsely asserts that "no one disputes" this characterization of the FERC's action. Resp. Br. 18. Both petitioners (at 28) and the Government (at 35) strongly dispute that characterization: FERC's order sought to regulate the fuel charges respondent imposes on its ratepayers, not the price respondent actually pays for its coal. Moreover, FERC's regulation of rates need not affect the inter-affiliate price; hence there is no conflict between the two regulatory regimes. See *infra* 16-18; Pet. Br. 43-44.

lic Utility Act was to curb abuses of public utility holding companies and their affiliates. See Pet. Br. 25-32. In Section 1(b)(2) of PUHCA, for example, Congress specifically condemned the "evils" that "result from an absence of arm's-length bargaining" in transactions involving subsidiary companies for "equipment, and materials." Congress then announced that because of such "abuses" a holding company could become "an agency, which, unless regulated, is injurious to investors, consumers, and the general public," and for that reason should be "eliminat[ed] except as otherwise expressly provided in this title." PUHCA § 1(c), 15 U.S.C. § 79a(c). Accordingly, Congress declared that "all the provisions of this title shall be interpreted to meet the problems and eliminate the evils as enumerated in this section." *Id.* Against this congressionally declared rule of construction, it would be wholly inappropriate to interpret Section 318 in a manner that permits public utility holding companies to use Section 13(b) of PUHCA as a device to avoid FERC regulation of their electric rates, and thereby to charge extravagantly higher rates than such regulation would allow.

The most effective means of achieving Congress's purpose is to interpret Section 318 as overriding regulation under the Federal Power Act *only* when mutually inconsistent obligations are imposed by or under that Act and by or under PUHCA. Interpreted that way, Section 318 serves its intended function by supplying a tie-breaker with respect to these two acts, but otherwise leaving the FERC and the SEC free to exercise plenary authority within their respective spheres. See Pet. Br. 25-32. It thereby ensures that both regulatory regimes will operate to the fullest possible extent, consistent with this Court's teaching that where two statutory schemes "are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Ruckelshaus* v.

Monsanto Co., 467 U.S. 986, 1018 (1984); see also *Louisiana Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355, 370 (1986) ("where possible, provisions of a statute should be read not to create a conflict").

Moreover, only this interpretation of Section 318 eliminates regulatory gaps. Requiring inconsistent obligations as the trigger for Section 318 ensures that when the FERC is deprived of its jurisdiction, the FERC action is squarely in conflict with a self-operative provision of PUHCA or some actual exercise of regulatory authority by the SEC. A court order compelling the FERC to withdraw under such circumstances will not create a regulatory gap because either PUHCA or the SEC, by definition, has in place a specific regulatory obligation.[6]

By contrast, respondent's argument that the FERC should be deprived of its authority to regulate interstate rates whenever a court determines that a FERC order will "frustrate the purpose" of the SEC is wholly at odds with the purpose and structure of the Public Utility Act. It also finds no basis in the language of Section 318. Respondent borrows its "frustration of purpose" standard from preemption cases, but makes no effort to explain why Congress would have incorporated that standard into a statute that only resolves conflicts in "requirements" imposed by two federal agencies or their organic statutes. See Pet. Br. 18-20. The natural reading of that language is quite the opposite: It may make sense to describe "regulations" or "orders" as conflicting in the sense of frustrating each others' purposes, but it makes no sense to speak of conflicting "requirements" imposed by those regulations or orders *except* in the

[6] Respondent asserts that its interpretation creates no gap because one agency or the other still would presumably have *jurisdiction* to regulate the transaction. See Resp. Br. 11, 42. But that is beside the point. Section 1 of PUHCA could not more plainly evince Congress's intent to ensure actual regulatory *control* to prevent abuse. See Pet. Br. 26.

sense of inconsistent obligations.[7] Respondent's "frustration of purpose" argument is therefore contrary to the plain statutory language for much the same reasons that the court of appeals's "field preemption" argument runs afoul of that language. See Pet. Br. 18-20, 23-25.

But even more dubious is the assumption that underlies respondent's argument—*i.e.*, that Congress intended to allow courts to guess as to when a FERC requirement "frustrates" an SEC purpose or "stands as an obstacle to the full achievement" of the SEC's objectives. These terms simply were not considered in any way synonymous with "conflict" in 1935 and therefore cannot properly be incorporated into the word "conflict" in Section 318's title.[8] Moreover, the interpretation proposed by

[7] There is no merit to respondent's argument that, in light of Section 21 of PUHCA (15 U.S.C. § 79u), Section 318 would be "unnecessary" if read as applying solely to conflicts based upon inconsistent obligations. Resp. Br. 30. As respondent itself recognizes, the language of Section 21 is *broader* than that of Section 318, because it does not require conflicting "requirements." Absent Section 318, therefore, SEC orders and regulations might have a broader preemptive effect on FERC regulation than Section 318 permits. Section 318 was thus necessary to effectuate Congress's purpose of comprehensively regulating both the inter-affiliate transaction aspects (through SEC regulation) *and* the rate consequences (through FERC regulation) of the activities of PUHCA-regulated utilities.

[8] To petitioners' knowledge, the first decision to suggest any equivalency between "conflict" and "frustration of purpose" was *Hines* v. *Davidowitz*, 312 U.S. 52 (1941), which was decided six years *after* Congress enacted the statute at issue. Thus, statements in the legislative history to the effect that Section 318 reaches "any conflict" between the SEC and the FERC cannot be read, as respondent suggests (Resp. Br. 30-31), to mean that Congress intended to reach "frustration of purpose" conflicts as well as conflicts based upon mutually inconsistent obligations.

Moreover, even in the area of the law—the Supremacy Clause—where these phrases derive their meaning, this Court has never held that state law is preempted simply because it "frustrates" *an agency*'s purpose rather than that of Congress. Instead, absent field preemption, agencies are expected to act with greater precision and to express explicitly their intention to preempt. Compare *Hills-*

respondent will necessarily expand the instances in which Section 318 will be brought into play, in contravention of Congress's clear expectation that the FERC and the SEC would operate cooperatively in their respective spheres. See Pet. Br. 22, 25-35. It is inconceivable that Congress, given its plain hostility to public utility holding companies in general and to inter-affiliate transactions in particular (see *supra* 4-5), would have chosen to favor those entities with a "conflict" rule that permits them to evade FERC ratemaking review whenever they can convince a court (or even the SEC itself) that FERC regulation will somehow "frustrate" the SEC's goal of protecting the holding company's investors.[9]

In sum, respondent has premised its entire alternative ground for affirmance on a misconception of the congres-

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borough County v. *Automated Medical Laboratories, Inc.*, 471 U.S. 707 (1985), with *United States* v. *Shimer*, 367 U.S. 374 (1961).

[9] Even if a "frustration of purpose" standard applied, respondent offers no persuasive reason why the FERC order in this case frustrates the purposes of Section 13(b) or of the SEC's implementing regulations. Respondent's naked assertions that the FERC's order frustrates a "congressional determination that consumers and the public interest are best protected by application of a cost standard to affiliate transactions" (Resp. Br. 37-38) and would defeat the "balance between the interests of consumers and investors that is reflected in section 13(b)" (Resp. Br. 38) merely beg the question of congressional intent. In fact, the language, structure and legislative history of the Public Utility Act of 1935 all demonstrate a "congressional determination" that consumers would be best protected by a system of *concurrent* FERC-SEC regulation. See Pet. Br. 17-35. Contrary to respondent's suggestion (Resp. Br. 38-39), moreover, the "bleeding" of utility companies about which Congress was concerned in 1935 referred to efforts by *holding companies* to drain away a utility's earnings and capital, *not* to the reduction in revenues that almost inevitably accompanies ratemaking review of a public utility's costs for the protection of consumers. See Pet. Br. 31 n.12. FERC's order therefore cannot be said to "frustrate" Congress's purpose. Respondent's suggestion that FERC's order somehow frustrates the purposes of the SEC's implementing regulations or orders (Resp. Br. 38) is equally implausible. See *infra* 14-18.

sional scheme embodied in the Public Utility Act of 1935. Congress meant to restrict the operations of holding companies, not to restrict the dual regulatory system that was designed to protect consumers (as well as investors) from transactions in which affiliates purchased goods from each other at "costs" that exceeded market rates by almost 100 per cent. See Pet. Br. 34 (quoting Rep. Rayburn's condemnation of inflated costs in affiliate transactions as one of 17 "Reprehensible Practices of Holding Companies"). Only a conflicting requirements standard, *i.e.*, one that ousts the FERC of its jurisdiction only when its obligations are mutually inconsistent with those imposed by the SEC, fully accomplishes Congress's purpose in enacting the Public Utility Act generally and Section 318 specifically. And if there were any doubt about the matter, this Court, for reasons explained at length in petitioners' opening brief (Pet. Br. 35-39) should defer to the FERC's holding that Section 318 imposes an inconsistent obligations standard. See Pet. App. 37a-38a.

III.

As demonstrated above, Section 318 divests the FERC of its jurisdiction only if PUHCA or the SEC imposes an obligation that is inconsistent with the obligation imposed by the FPA or the FERC. As shown below, there is no conflict between any requirement imposed by the SEC and the requirements imposed by the FERC order at issue here.[10]

1. Respondent's assertion that Section 13(b) imposes an "at cost" pricing requirement on its coal contract

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[10] Petitioners agree with Ohio Power that the question whether the FERC's order is in conflict with PUHCA or with any rule or order imposed by the SEC is fairly presented in this case, has been fully briefed, and accordingly, "[t]here is no occasion for a remand" on that issue. Resp. Br. 10; see *id.* at 26-27.

(Resp. Br. 21, Amicus Br. 6) simply does not withstand scrutiny.[11] Section 13(b) does not confer upon an affiliate some absolute right to obtain its "costs" in any transaction with another affiliate. Such a standard would be an open invitation to holding companies to engage in "gold plating" and to shift costs to their affiliate supply subsidiaries. See Pet. Br. 33-34. This would be the very antithesis of what Congress intended, as it forcefully proclaimed in Sections 1(b)(2) and 1(c) of PUHCA. 15 U.S.C. §§ 79a(b)(2) and (c).

In fact, respondent bases its argument on an imagined Section 13(b), not the actual statutory provision. Absent an exemption, Section 13(b) makes unlawful *all* contract sales by a holding company subsidiary to an affiliated utility operating company unless they comply with "such terms and conditions and . . . such limitations and prohibitions as the [SEC] by rules and regulations or order shall prescribe." 15 U.S.C. § 79m(b). Congress directed the *SEC* to ensure that "such contracts are performed economically and efficiently for the benefit of such [affiliate] companies at cost, fairly and equitably allocated among such companies." *Id.* Thus, the "at cost" language is a directive to the SEC, not the regulated entity.

Moreover, Section 13(b) by its terms requires the SEC (a) to consider not only costs but also the economy and efficiency of the contracts themselves; and (b) to ensure that the relevant costs are fairly allocated among the affiliated companies. See *id.* In addition, Section 13(c) of PUHCA grants the SEC broad discretion in issuing rules, regulations and orders that prescribe protective "terms and conditions regarding the determination of costs and the allocation thereof" among affiliates. 15 U.S.C. § 79m(c).

[11] Respondent's claim that the court below "found" it "unquestioned" that the transaction was subject to a requirement under Section 13(b), Resp. Br. 27 n.21, simply mischaracterizes the decision below. What the court said was that "it is unquestioned that the coal-sale transactions between OPCO and SOCCO *are subject to SEC jurisdiction* under section 13(b)." Pet. App. 5a (emphasis added). The mere fact that respondent is subject to the SEC's jurisdiction does not give rise to any requirements.

For these reasons, Section 13(b) does not create a self-operative requirement that all of an affiliate's "costs" be passed on to the operating company that purchases its goods and services.[12] The only part of the provision that is self-operative is the injunction against the operation of the contract unless it complies with requirements imposed by the SEC. Thus, Section 13(b) imposes no "requirement" upon respondent,[13] and certainly does not compel respondent to charge rates that are based upon grossly excessive costs of goods purchased from its subsidiary.

Respondent's interpretation of Section 13(b) not only is unsupported by the plain language of the statute, but

[12] Respondent suggests (Resp. Br. 33-34) that because Section 13(b) was not listed in a letter from the SEC to this Court in *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119 (1944), Resp. Br. App. D at 98-99, as among the PUHCA provisions that are not self-operative, it must therefore be self-implementing. This argument is without merit. First, the SEC letter does not purport to include an exhaustive list of PUHCA provisions that are not self-operative. *Id.* at 99 ("The sections to which the argument might be applicable are 15(a), 20, 12(c) and 11(b)."). Second, and more significant, the operative language of Section 12(c) (making it unlawful to pay a dividend "in contravention of such rules and regulations or orders as the [SEC] deems necessary or appropriate")—which the SEC specifically identified as not self-operative—is almost identical to that in Section 13(b). 15 U.S.C. § 79*l*(c).

[13] Even if Section 13(b) somehow imposed requirements, by its terms it applies to SOCCO only, and not to respondent. Section 13(b) does not apply to companies that *purchase* goods from affiliates, but only to companies that *sell* goods. Because respondent does not sell goods to SOCCO, respondent simply is not subject to any "requirements" of Section 13(b). See Brief of *Amicus Curiae* American Public Power Association, *et al.*, at 7-11.

also is flatly contrary to the SEC's regulations implementing that provision. SEC Rule 90(a)(2), which contains the general limitation on transactions between affiliates, prohibits subsidiaries from selling goods or services "at *more* than cost." 17 C.F.R. § 250.90(a)(2) (emphasis added).[14] Moreover, Rule 92 states a special rule for the sale of goods produced by the seller: such goods may not be sold at a price that exceeds the market price. See 17 C.F.R. § 250.92.[15] This regulation was first adopted shortly after the enactment of Section 13(b) and implements the statute's mandate to the SEC to ensure economy and efficiency in the operation of authorized inter-affiliate contracts. See 1 Fed. Reg. 80 (1936). Thus, the SEC itself, in formal regulations, has rejected respondent's position that Section 13(b) *requires* an electric utility to pay no more and no less than "costs" for goods purchased from another affiliate of its holding company. The SEC's interpretation is clearly a permissible interpretation of Section 13(b) (see *Chevron U.S.A.*

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[14] Rule 90(a)(2) states: "No subsidiary company of a registered holding company . . . shall perform any service or construction for, or sell any goods to, or enter into contract to do so, at more than cost . . . ." 17 C.F.R. § 250.90(a)(2). By its terms, this regulation imposes a *ceiling* on the price which the seller may charge.

[15] Entitled "Sale of goods produced by the seller," Rule 92 provides that the sale of goods may not be made "at a price which exceeds the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere, or to furnish them itself, giving due regard to quality, quantity, regularity of supply, and other factors entering into the calculation of a fair price." 17 C.F.R. § 250.92. Contracts for the sale of goods are specifically exempted from Rule 90. See 17 C.F.R. § 250.90(d)(2) ("The price of services, construction, or goods need not be limited to cost . . . if . . . (2) such transaction consists of *a sale of goods produced by the seller*") (emphasis added).

v. *NRDC*, 467 U.S. 837, 843 (1984)) and lays to rest respondent's argument about the self-implementing nature of that provision.

2. Given Rule 92's establishment of a market-price standard for a sale of goods produced by an affiliate seller, it is equally clear that nothing in the SEC's regulations imposes a "requirement" that coal produced by SOCCO must be sold to Ohio Power at cost, regardless of the market price. SEC Rule 80(b) states that coal is a "good" to which Rule 92 applies. 17 C.F.R. § 250.80(b). And the SEC has specifically held that the comparable market test applies to inter-affiliate sales of coal produced by a holding company subsidiary. *In re East St. Louis Light & Power Co.*, 2 S.E.C. 358 (1937).[16]

In arguing that the market price limit (contained in both the FERC order and SEC Rule 92) should not be applied to the contract here, respondent notes a number of alleged benefits from its captive coal arrangement. Resp. Br. 32-33. Even if those concerns (which were not litigated before the FERC[17]) were somehow before this Court, the SEC recognized in its *East St.*

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[16] In that order, issued two years after the enactment of the Public Utility Act and a year after the SEC's adoption of the predecessor to Rule 92, the Commission recognized that a price term in a captive coal contract limiting the price to that "at which the purchaser might reasonably be expected to obtain comparable coal elsewhere, giving due regard to quality, quantity, regularity of supply, and other factors entering into the calculation of a fair price . . . *is in effect the requirement of Rule [92] which will continue to be applicable to the [coal company] as a subsidiary of the applicant.*" *In re East St. Louis Light & Power Co.*, 2 S.E.C. 358, 359 (1937) (emphasis added).

[17] Respondent's reliance upon findings of the ALJ based upon evidence that the mines were operated "efficiently" is misleading. That evidence was not contested by petitioners before the ALJ because it is irrelevant under the FERC's market-price test. See Pet. App. 43a-44a. Thus, the findings of the ALJ in no way detract from the FERC's clear holding that the coal charges respondent sought to pass on to petitioners were excessive.

Louis decision that a market price limitation is fully consistent with any benefits that may accrue from inter-affiliate contracts. Notwithstanding those benefits, the SEC found that its market price standard is compelled by "certain dangers inherent in the ownership by public utility companies of their sources of fuel." *In re East St. Louis Light & Power Co.*, 2 S.E.C. at 360. In short, respondent cannot seriously contend that the FERC's rate order conflicts with the SEC's regulations.

3. Contrary to respondent's suggestion that "there is agreement" that SEC orders impose a "requirement" that respondent pay SOCCO its "costs" (Resp. Br. 9-10), *nothing* in the orders cited by respondent requires Ohio Power to take coal at cost from SOCCO or purports to set the price for coal.[18] At bottom, respondent's entire argument is predicated on the contention that the SEC orders exempt the contract between respondent and SOCCO from Rule 92. Respondent admits: "In the absence of the SEC orders, it might be open to question whether the market test laid out in the SEC's Rule 92 for goods produced by the seller applied instead." Resp. Br. 18 n.11. But the orders in no way indicate that Rule 92 does *not* apply here.

[18] In respondent's words, the orders "approved Ohio Power's sale of coal mines and leases to Southern Ohio, approved borrowings by Southern Ohio to reduce its cost of capital, approved further investments by Ohio Power in Southern Ohio to finance efficiency improvements in mining operations, and required both Ohio Power and Southern Ohio to file quarterly financial information and statements." Resp. Br. 6. None of those orders (1) required Ohio Power to enter into the contract with SOCCO; (2) required Ohio Power to purchase any coal from SOCCO; or (3) required Ohio Power to pay any particular price. One order simply *recited* that, under the terms of the contract, Ohio Power would be paying "cost." See *Ohio Power Co.*, Holding Company Act Release No. 17383 at 2 (Dec. 2, 1971). But that order did not purport to impose a "cost" *requirement*. *Id.* The *only* source of any obligation on Ohio Power's part is the contract with SOCCO. But that contract was never approved by the SEC. See *infra* 15.

First, in contrast to Section 13(b) itself, the SEC regulations regarding the sale of coal produced by the seller are self-operative. Thus, contrary to the suggestions of respondent and its *amicus*, see Resp. Br. 18; Amicus Br. 22-24, the SEC was not required to approve the captive coal contract between Ohio Power and SOCCO; the SEC was never asked to approve that contract; and the SEC never did approve that contract.[19]

Second, as petitioners demonstrated in their opening brief, none of the orders relied on by respondent was issued under Section 13(b)—all were issued pursuant to other provisions of PUHCA. Pet. Br. 44 n.29. Moreover, SEC Rule 88(b) provides the only procedure for the SEC to make a finding that a particular holding company subsidiary complies with Section 13(b). See 17 C.F.R. § 250.88(b). None of the orders on which respondent relies was applied for or issued under this provision.

Third, the SEC has never exempted respondent's purchases of SOCCO-produced coal from Rule 92. SEC Rule 100 provides a specific procedure for the Commission to exempt "any transaction subject to the requirements of any rule promulgated under [PUHCA]." 17 C.F.R. § 250.100. But respondent never availed itself of that provision, and the SEC never invoked it. Clearly, the comparable market test of Rule 92 remains in effect with respect to this transaction.

4. Finally, even assuming that something in the SEC's regulatory scheme somehow imposes a requirement on

[19] SEC regulations make plain that a contract for the sale of goods produced by the seller need not receive specific SEC approval: "Any subsidiary of a registered holding company . . . may . . . sell goods, to an associate company thereof if . . . [s]uch transaction consists of a sale of goods produced by the seller." 17 C.F.R. § 250.87(b)(6). Consequently, such contracts need only comply with the comparable market standard of Rule 92, which governs the "sale of goods produced by the seller."

respondent with respect to the purchase price of SOCCO coal, it is clear that the requirement is, at most, a cost ceiling. As respondent itself admits, the three most recent orders state that " '[t]he price at which Ohio coal is sold to AEP system companies *will not exceed* the cost thereof to the seller.' " Resp. Br. at 5-6 (quoting *Ohio Power Co.*, Holding Company Act Release No. 20515, 14 SEC Docket 928, 929, 930 (1978) (emphasis by respondent)). As petitioners demonstrated in their opening brief (Pet. Br. 43-44), the FERC's order does not conflict with this cost ceiling.

Respondent nevertheless argues that there is a conflict in requirements in this case because the FERC's order assumes that Ohio Power could pass on to customers the market price for coal even when that price is more than actual cost, but that the SEC, by imposing cost as a ceiling, would preclude Ohio Power from obtaining in its rates the benefit of the market price. Although Ohio Power asserts that "[i]t is common ground that [this constitutes] an 'actual conflict,' " (Resp. Br. 14) its claim is mistaken and its underlying analysis reflects a total misunderstanding of Section 318 and the SEC rules under Section 13(b).

There is no conflict, even in respondent's extra-record hypothetical where market exceeds cost, because the "requirements" imposed by FERC and the SEC do not impose inconsistent obligations on Ohio Power.[20] Contrary

[20] Respondent is thus flatly wrong in claiming (Resp. Br. 15) that the FERC's rule imposing a market test whether the market price is above or below cost "could *only* be supported . . . on the 'different subject matters' rationale." In fact, that rule is fully consistent with Section 318 simply because it is always possible for a public utility to comply with that rule and with the SEC's rules regarding inter-affiliate contracts, regardless of whether Rule 90 or Rule 92 applies. See *supra* 12. There is thus no merit to respondent's argument (Resp. Br. 15) that the FERC's decision must be vacated "once it is conceded that the same subject matter was before the FERC and the SEC."

to respondent's repeated assertion (Resp. Br. 10-11, 27-28), petitioners do *not* argue for a "lower-of-cost-or-market-standard." In the hypothetical posed by respondent, Ohio Power would pay actual cost to SOCCO (consistent with respondent's interpretation of SEC requirements), but would gain the benefit of its efficiency and economy by being allowed to charge petitioners the market price pursuant to the FERC rate order.[21] Thus, the standard applied by the FERC in determining respondent's rates would be a "market" standard regardless of the relationship between the market price and SOCCO's costs, and regardless of the standard under which the SEC regulates the price respondent pays to SOCCO.[22] Petitioners have consistently recognized this built-in incentive for Ohio Power to operate efficiently, and there is nothing in the FERC's submission to this

[21] In light of Ohio Power's opportunity to recover market prices above costs under the FERC's order, respondent cannot legitimately complain that the FERC's order in *this* case may result in "trapped costs." Resp. Br. 36. But even if trapped costs actually were at issue, respondent's claim has no merit. Respondent argues this point as though there were some well-established maxim—*e.g.*, "the law abhors a trapped cost"—that supports its position. But no such maxim has ever been articulated or applied by this or any other court. To the contrary, *any* ratemaking review poses the risk that some costs actually incurred by a regulated utility will be disallowed —as imprudently incurred, for example—and hence "trapped."

[22] There is no merit to respondent's argument that this analysis "makes the SEC's regulation under section 13(b) [of PUHCA] pointless" because the intracorporate price "has no impact on consumers unless that price is reflected in electric rates." Resp. Br. 23. In fact, the SEC's regulations under Section 13(b) serve their purpose of protecting investors from manipulative intracorporate practices regardless of the FERC's ratemaking treatment of the prices a utility pays for goods and services from its affiliates. The transfer prices paid for such goods and services can dramatically affect the returns earned by investors in the affiliates and the utility, respectively; those prices, therefore, are not "meaningless bookeeping entries," as respondent claims. Resp. Br. 23.

Court that indicates that a conflict would exist in the situation posed by respondent.

In any event, there clearly is no "conflict" in requirements in the case before the Court. FERC therefore retains its vital authority under the FPA to protect consumers, such as petitioners, from excessive rates charged for electricity.

* * * *

It has been 45 years since this Court was called upon to interpret Section 318 of the FPA, and 25 years since any court of appeals was asked to construe that provision. This judicial quiescence is explained by the understanding that has existed since 1935 within all branches of the federal government that companies subject to PUHCA must comply with requirements, even though burdensome, of two different agencies—the FERC and the SEC—aimed in different ways to achieve the same overall purpose of curbing abuses by these companies. And thus, only when those two agencies appear to impose mutually inconsistent obligations is there any call for judicial interference under Section 318.

If the Court reaffirms that understanding, then neither it nor any other reviewing court likely will have reason to construe this provision for decades. On the other hand, if this Court adopts either of the interpretations offered by respondent and its *amicus*, then every FERC rate order disliked by a public utility affiliate of a registered holding company will be subject to judicial challenge under Section 318. Congress never intended this provision to serve as a shield from effective ratemaking for electric utilities that directly or indirectly serve 50 million households. Accordingly, the Court should respect Congress's intent by holding that the FERC's rate order in this case imposes no obligations inconsistent with any SEC requirement and therefore does not violate Section 318.

CONCLUSION

For the foregoing reasons, and for the reasons stated in petitioners' opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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No. 89-1283

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

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Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF AMERICAN PUBLIC POWER ASSOCIATION, ENVIRONMENTAL ACTION AND CONSUMER FEDERATION OF AMERICA AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

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QUESTIONS PRESENTED

1. Whether Section 13(b) of the Public Utility Holding Company Act ("PUHCA"), which prohibits a subsidiary of a public utility holding company from selling goods to an associated utility at a price exceeding the seller's "cost," bars the Federal Energy Regulatory Commission ("FERC") from finding the utility's electric rates to be "unjust" or "unreasonable" under Sections 205 and 206 of the Federal Power Act ("FPA")," where

   a. the utility voluntarily purchases high-priced coal from its subsidiary when less expensive coal is available from unaffiliated companies;

   b. FPA Section 318 provides that if the same "person" is subject both to a requirement under PUHCA, and to a requirement under the FPA with respect to the same subject matter, the PUHCA requirement applies to such person and the FPA requirement does not;

   c. PUHCA Section 13(b) applies to the coal subsidiary while FPA Sections 205 and 206 apply to the utility subsidiary; and

   d. both statutes expressly treat the coal subsidiary, the utility subsidiary and the holding company as distinct "persons."

2. Whether FERC's order created "trapped costs," as defined by *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), where

   a. In *Nantahala* and *Mississippi*, costs were "trapped" because two agencies having jurisdiction over the same utility issued conflicting orders, the first agency directing the utility to buy its affiliate's electricity and the second agency

deeming the utility free to buy electricity elsewhere; while

b. in this case, the first agency has jurisdiction over the coal seller, the second agency has jurisdiction over the utility buyer, and the utility buys the coal voluntarily.

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BRIEF OF AMERICAN PUBLIC POWER ASSOCIATION, ENVIRONMENTAL ACTION AND CONSUMER FEDERATION OF AMERICA AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

INTEREST OF AMERICAN PUBLIC POWER ASSOCIATION, ENVIRONMENTAL ACTION AND CONSUMER FEDERATION OF AMERICA

American Public Power Association ("APPA") is a national service organization representing more than 1,750 local, publicly owned electric utilities in 48 states, Puerto Rico, the Virgin Islands, American Samoa and Guam. Local publicly owned utilities serve approximately 14% of all U.S. consumers. Environmental Action ("EA"), founded in 1971, is a non-profit research, educational and advocacy organization headquartered in Washington, D.C. On behalf of its national membership, EA advocates responsible environmental and energy policies. Consumer Federation of America ("CFA"), founded in 1968, is the nation's largest consumer advocacy organization. It is composed of over 250 state and

local affiliates, representing senior citizen, low-income, labor, farm, public power and cooperative organizations.*

APPA, EA and CFA (hereinafter, *Amici*) represent customers of electric utilities. Many APPA members buy at wholesale from utility subsidiaries of holding companies whose corporate structures are regulated by the Securities and Exchange Commission ("SEC") under the Public Utility Holding Company Act, 15 U.S.C. § 79 *et seq.* ("PUHCA"). Sales at wholesale are subject to "just and reasonable" rate regulation under the Federal Power Act ("FPA"), 16 U.S.C. § 792 *et seq.* Members of EA and CFA are retail customers. While retail rates are set nominally by state public service commissions, these commissions frequently must include in retail rates the FERC-mandated costs of a utility's wholesale power purchases. *See Mississippi Power & Light v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988).

All retail customers, and many wholesale customers, lack purchasing alternatives because their utility suppliers control exclusive service territories. In the absence of competition, these customers depend on regulation to assure that utilities operate with all the efficiencies a competitive market would demand.

Congress enacted the FPA to provide that assurance. FPA Section 205, 16 U.S.C. § 824d, requires that utility rates be "just and reasonable." Congress has equated the "just and reasonable" rate with the "'true' market price." *Federal Power Commission v. Texaco*, 417 U.S. 380, 398-99 (1974) (*quoting Federal Power Commission v. Sunray DX Oil Co.*, 391 U.S. 9, 25 (1968)). The "true" market price is, in turn, "the price that would result through the mechanism of a truly competitive market. . . ." *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir. 1984). It follows that rate regulators like FERC must apply market pressures. *Democratic Central Comm. of D.C. v. WMATC*, 485 F.2d 886, 907 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974).[1]

* The parties have consented to the filing of this brief. Copies of their letters have been lodged with the Clerk.

Faced with FERC scrutiny, an independent utility must shop the market for the lowest-price goods and services. Under the Court of Appeals' decision, however, the utility subsidiary of a holding company can disregard the market and buy from its affiliate. Provided the affiliated seller's price does not exceed its "cost," as defined by the SEC under PUHCA, FERC must treat the utility's purchase as "just and reasonable," no matter how inflated the cost is relative to market. If utility subsidiaries may use corporate form to escape market accountability, consumers will suffer from high prices and production inefficiencies.[2]

The lower court's reasoning threatens millions of electric consumers. There are nine utility holding company systems currently subject to PUHCA's interaffiliate transaction rules. Pet. Jur. Br. at 17. Utility subsidiaries of these systems serve, directly or indirectly, about 49 million households in 30 states and the District of Columbia. That number represents a starting point only. Mergers and acquisitions in the electric industry may

[1] *See also Midwestern Gas Transmission Co.*, 36 F.P.C. 61, 79 (1966) (while "[m]anagements of unregulated businesses . . . have no alternative to efficiency," utility management "does not have quite the same incentive;" therefore, regulatory scrutiny must ensure that all costs are "necessary and prudent"), *aff'd sub nom., Midwestern Gas Transmission Co. v. FPC*, 388 F.2d 444 (7th Cir.), *cert. denied*, 392 U.S. 928 (1968).

[2] *Cf. Public Service Co. of New Mexico*, 17 F.E.R.C. ¶ 61,123 at p. 61,246 (1981) ("industries that operate with the assurance that their prices will recover costs plus a reasonable return are less innovative and efficient than those whose prices are subject to a competitive market"), *aff'd sub nom., Public Service Co. of New Mexico v. FERC*, 832 F.2d 1201 (10th Cir. 1987).

expand existing holding companies and create new ones.[3] As independent single-state utilities become affiliates of multistate holding companies, they too can conduct internal transactions free of FERC (market) scrutiny.

The goods and services involved can cover the full range of inputs to electricity production. Many PUHCA-regulated holding companies already have created special "service" subsidiaries to sell numerous goods and services, *e.g.*, power supply planning, legal services, land ownership and accounting, to utilities who formerly performed such functions themselves. Responsibility for power plant operations—historically a utility's most significant function—may move to nonutility subsidiaries as well.[4] When the nonutility subsidiary sells these goods and services to the utility at "cost," rate regulation under the FPA would consist of routine passthroughs to consumers, unchecked by market forces.

STATEMENT OF THE CASE

In a series of orders beginning in 1971, the SEC authorized the formation of Southern Ohio Coal Company ("SOCCO"), a subsidiary of the nation's largest public utility holding company, American Electric Power Co.

[3] *See, e.g., Southern California Edison Co.*, 47 F.E.R.C. ¶ 61,196 (1989) (setting for hearing proposed acquisition by Southern California Edison Co. of San Diego Gas & Electric Co.); *Northeast Utilities Service Co.*, 50 F.E.R.C. ¶ 61,266 (1990) (setting for hearing proposed acquisition by Northeast Utilities of Public Service Co. of New Hampshire); *Environmental Action, et al. v. SEC*, 895 F.2d 1255 (9th Cir. 1990) (affirming SEC decision approving holding company's acquisition of new utility subsidiary to serve wholesale customers in Western states), *petition for rehearing pending* (filed Feb. 23, 1990).

[4] *See, e.g., Entergy Operations, Inc.*, SEC Admin. Proc. No. 70-7879 (application filed Sept. 25, 1989) (proposal to create subsidiary to perform nuclear operation and management services for three utility affiliates); *Northeast Utilities Service Co.*, SEC Admin. Proc. 70-7695 (application filed Jan. 11, 1990) (proposing, *inter alia*, creation of special subsidiary to operate Seabrook plant owned by utility affiliate).

("AEP"). SOCCO would mine coal and sell it to utility subsidiaries of AEP, including Ohio Power Company ("OPCO"). The SEC orders stated, *inter alia*, "[t]hat the charges for coal by [SOCCO] will be based on an amount equal to the actual cost of [SOCCO] in developing the reserve and mining such coal." *Ohio Power Co.*, SEC Release No. 17,383 at 2 (Dec. 2, 1971). OPCO purchased coal from SOCCO and used the coal to generate electricity for sale at wholesale and retail.

In 1982, FERC initiated a rate proceeding under the FPA to review the wholesale rates OPCO charged its municipal customers in Ohio. FERC found that OPCO's wholesale electric rates were not "just and reasonable," as required by FPA Sections 205 and 206, 16 U.S.C. §§ 824d and 824e, because OPCO had paid SOCCO a coal price exceeding market alternatives. FERC disallowed from OPCO's rates any SOCCO coal purchase costs exceeding "the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier." *Ohio Power Co.*, 39 F.E.R.C. ¶ 61,098 (1987) (*quoting Public Service Co. of New Mexico*, 17 F.E.R.C. ¶ 61,123 (1981), *aff'd sub nom., Public Service Co. of New Mexico v. FERC*, 832 F.2d 1201 (10th Cir. 1987)).

The Court of Appeals for the District of Columbia vacated FERC's decision. *Ohio Power Co. v. FERC*, 880 F.2d 1400 (D.C. Cir. 1989). The lower court found that although OPCO was subject to FPA Section 205, OPCO also "plainly is . . . subject to [PUHCA] section 13(b) [15 U.S.C. sec. 79m(b)] with respect to its contractual relations with SOCCO." The court concluded that under FPA Section 318, 16 U.S.C. § 825q, concerning "Conflicts of Jurisdiction," "it is for the SEC rather than FERC to determine the inter-associate price." 880 F.2d at 1408. The Ohio municipal customers, Arcadia *et al.*, then sought review in this Court.

SUMMARY OF ARGUMENT

The Court of Appeals misread Section 318. Section 318 states, unambiguously, that FERC review is precluded under the Federal Power Act only when a single "person" is subject to a requirement under both PUHCA and the FPA with respect to the same subject matter. FPA Section 205 applies to OPCO, while PUHCA Section 13(b) applies to SOCCO. Because OPCO and SOCCO are different persons under both the FPA and PUHCA, there is no "person" subject to provisions of both statutes. Section 318 does not apply to this case.

The Court of Appeals reopened a regulatory gap Congress closed 55 years ago. The Public Utility Act of 1935 created a dual scheme of regulation. Title I of the Act, PUHCA, relates to corporate form: it directs the SEC to guard against holding company structures which enable utilities to inflate costs or evade rate regulation. Title II of the Act, the FPA, relates to operations: it directs FERC to ensure that utilities operate with all reasonable economies. Under these statutes, the regulatory result does not depend on corporate form.

In the OPCO-SOCCO relationship, the SEC is to police corporate structure by setting maximum prices for non-utility sales. The FERC is to police operations by inducing the utility to shop for the lowest priced goods and services. There is no need for Section 318 because there is no "conflict of jurisdiction."

The lower court also erred in applying the "trapped cost" analysis of *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). In *Nantahala* and *Mississippi*, the "trapping" took place because one agency (FERC) ordered a utility to take a certain action; then another agency (a state commission) set the utility's rates as if the utility had taken an entirely different action. The facts here are fundamentally different. No agency directed, or had the authority to direct, OPCO to buy coal from SOCCO.

ARGUMENT

I. SECTION 318 DOES NOT APPLY BECAUSE NO SINGLE "PERSON" IS SUBJECT TO A REQUIREMENT OF BOTH STATUTES

A. Introduction

Section 318 provides (emphasis added):

> If, with respect to the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, *any person* is subject both to a requirement of [PUHCA] . . . and to a requirement of [FPA] . . . , the requirement of [PUHCA] shall apply to *such person*, and *such person* shall not be subject to the requirement of [FPA] . . . , with respect to the same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of [PUHCA], in which case the requirements of [the FPA] shall apply to such person.

Section 318 is unambiguous. FERC review under the Federal Power Act is ousted only when a single "person" is subject to a requirement under both statutes. As explained in Part I.B, *infra*, FPA Section 205 applies to OPCO, while PUHCA Section 13(b) (15 U.S.C. § 79m(b)) applies to SOCCO. Because OPCO and SOCCO are different persons under both the FPA and PUHCA, there is no "person" subject to provisions of both statutes. Section 318 does not apply to this case.

Part I.C explains that this commonsense reading of Section 318 not only heeds Congress' words; it also produces the result Congress intended: dual, not duplicative, regulation. Part I.D contends that by disregarding Congress' language, the Court of Appeals weakened the very regulatory tools Congress meant to strengthen.

B. Section 205 of FPA Applies to OPCO While Section 13(b) of PUHCA Applies to SOCCO; and OPCO and SOCCO are not the Same "Person"

The Court treated OPCO and SOCCO as the same "person" for purposes of Section 318, and then concluded that this "person" was subject to a requirement of both PUHCA and FPA with respect to the same "subject matter." Without explanation, the Court ignored express statutory language which makes OPCO and SOCCO separate "persons."

OPCO: FPA Section 205(a) provides that "[a]ll rates and charges made . . . by any *public utility* . . . shall be just and reasonable (emphasis added). FPA Section 201(e), 16 U.S.C. § 824(e), defines a "public utility" as "any *person* who owns or operates facilities subject to the jurisdiction of the [FERC]." Here, that "public utility" ("person") is OPCO.

SOCCO: PUHCA Section 13(b) provides that

> it shall be unlawful for any subsidiary *company* of any registered holding company . . . to enter into or take any step in the performance of any . . . sales . . . contract by which such company undertakes to . . . sell goods to[] any associate company thereof except in accordance with such terms and conditions . . . as the Commission . . . shall prescribe.

(emphasis added). Section 13(b), by its explicit terms, applies only to one "subsidiary company": the seller. Here, that seller is SOCCO.

It is clear from the face of the statute that SOCCO is subject to PUHCA but not the FPA; while OPCO is subject to the FPA but not PUHCA. The only remaining question, in determining whether Section 318 applies, is whether SOCCO and OPCO are separate "persons."

Under PUHCA Section 2(a)(1), 15 U.S.C. § 79b(a)(1), a "person" means an "individual or a company." The FPA contains virtually the same definition. *See* 16 U.S.C. § 796(4) ("person" means "an individual or a corporation"). A "person" is not two individuals or two companies. A "person" is one individual or one company. SOCCO is a company, and OPCO is a separate company. SOCCO and OPCO cannot be the same "person."

The Court of Appeals ignored this entire issue. The Court of Appeals interpreted Section 318 as if it read as follows:

> Where two associate companies are parties to a transaction, and one company is subject to a requirement of the Federal Power Act while the other company is subject to a requirement of PUHCA with respect to the same subject matter, the requirement of PUHCA shall apply and the requirement of the Federal Power Act shall not.

That is not what Section 318 says. Section 318, as Congress wrote it, applies only when *a single person* is subject to both statutes. Because no single person in this case is subject to both statutes, the Court of Appeals' decision must be reversed.

Respondent may assert that even if OPCO and SOCCO are not the same "person" for the purposes of Section 318, the missing "person" is AEP, the holding company. That argument has no statutory basis. A holding *company* is a distinct "person" in the same legal sense that its subsidiary company is. (Under PUHCA Section 2(a)(1), a "person" is an "individual or a *company*.") As a "person," the holding company is legally distinct from each of its subsidiaries.

Both statutes expressly confirm the distinction between holding company and subsidiary. PUHCA Section 2(a)(7)(A), 15 U.S.C. § 79b(a)(7)(A), distinguishes the holding company from its public utility subsidiary: a "holding company" means "any company which directly or indirectly owns . . . 10 per centum or more of the outstanding voting securities of a public-utility com-

pany. . . .").[5] The FPA makes the same distinction. In *Central Illinois Public Service Company*, 42 F.E.R.C. ¶ 61,073 (1988), CIPS, a utility, sought to create a new holding company ("HC") to acquire all of CIPS' stock. CIPS argued that Section 318 precluded FERC review because HC's acquisition of CIPS's stock was subject to Sections 9 and 10 of PUHCA. (Absent Section 318, FERC would review this "disposition of . . . jurisdictional facilities" under Section 203 of the FPA. *See Central Vermont Public Service Company*, 39 F.E.R.C. ¶ 61,295 (1987)). FERC disagreed:

> [W]hile section 318 would deprive [FERC] of jurisdiction if a "person" is also subject to SEC regulation with respect to the same subject matter, here different persons are involved. CIPS and the holding company it wishes to create are two separate corporate entities, and each is regulated by a different agency. [FERC] has jurisdiction over CIPS, the operating utility, and with respect to this transaction CIPS is not subject to SEC regulation under PUHCA.

42 F.E.R.C. at p. 61,328.[6]

The holding company is distinct not only from its utility subsidiaries, but also from its nonutility subsidiaries. PUHCA Section 13 makes this plain. Section 13 distinguishes different types of interaffiliate transactions based on which persons are involved. Section 13(a) flatly prohibits a "registered holding company" from performing services for or selling goods to a public utility company or "mutual service company" which is a member of the same holding company system. But the prohibition against holding-company-as-seller does not apply to subsidiary-company-as-seller: under Section 13(b), a

[5] *See also* PUHCA Section 2(a)(8) (distinguishing "subsidiary" from "holding company").

[6] *Accord, Savannah Electric and Power Co.*, 42 F.E.R.C. ¶ 61,240 at p. 61,779 (1988).

"subsidiary company" may provide goods and services to associate companies, subject to SEC rules. If Congress had viewed the holding company as indistinct from its subsidiaries, Section 13 would not vary the interaffiliate transaction rules depending on which persons were transacting.

The Court of Appeals rejected the FERC's jurisdictional analysis in part because, in the Court's view, "there could never be a conflict between the SEC and FERC with respect to a subject matter not specifically enumerated in section 318." 880 F.2d at 1406. If one heeds Congress' "person" language, that criticism evaporates. Suppose OPCO produced its own coal and sold its excess to another utility subsidiary of AEP. PUHCA Section 13(b) would apply to OPCO, since a "subsidiary of [a] registered holding company" would be selling goods to an "associate company thereof." Under Section 13(b), the SEC could limit OPCO's sales price to "cost." But what if OPCO's wholesale electric customers then persuade FERC that OPCO was operating inefficiently by selling its coal at a price below market value? Absent Section 318, FERC could (1) deem OPCO to have charged its associate a higher price for coal, and then (2) lower OPCO's wholesale electric rates to reflect the higher hypothetical revenues OPCO would have received from the properly priced coal sale. But Section 318 would bar FERC from acting; otherwise OPCO, a single "person," would be subject to a requirement under both statutes with respect to the same subject matter. Under the "person" analysis, Section 318 retains its purpose.

C. Adherence to Congress' Language Produces What Congress Intended: Dual, not Duplicative, Regulation

The Public Utility Act of 1935 subjected holding companies like AEP to dual regulation. The Act "had two primary purposes: to curb abusive practices of public utility companies by bringing them under effective con-

trol, and to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce." *Gulf States Utilities Co. v. FPC*, 411 U.S. 747, 758 (1973).[7] Title I (PUHCA) prevents abusive corporate structures, while Title II (FPA) ensures just and reasonable operations. This structural-operational distinction has been confirmed by the Courts. *See City of Lafayette v. SEC*, 454 F.2d 941, 955 (D.C. Cir. 1971) ("SEC has no jurisdiction over operations and stands in a different posture from the FPC which, as we have already noted, has regulatory jurisdiction over operations"), *aff'd, Gulf States, supra.*

Congress enacted a distinct structural review in part to preserve and strengthen traditional operational review. As PUHCA's Senate sponsor declared:

> The very essence of a common-sense scheme of public regulation is, therefore, that the corporations to be regulated should not be permitted to reach a size and power and a complication where a Federal regulatory body cannot be a match for them. . . . [PUHCA] is an attempt to whittle down the size and power and complication of these giant corporations until the Federal and State commission can be a match for them.

79 Cong. Rec. 9043 (1935) (Sen. Wheeler) (June 11).

Properly interpreted, Section 318 should subtract nothing from Congress' dual regulatory scheme. The legislative history confirms that Section 318 prevents duplication, not duality. During the PUHCA debate, Rep. Wadsworth offered an amendment to transfer PUHCA responsibility from the SEC to the FPC. After learning of the existence of Section 318, he withdrew his amendment, explaining:

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[7] *See also* S. Rep. No. 621, 74th Cong., 1st Sess. at 17 (1935) (FPA "seeks to bring about the regional coordination of the operating facilities of the interstate utilities along the same lines within which the financial and managerial control is limited by" PUHCA).

> Mr. Chairman, when I offered this amendment on Saturday afternoon I did so having in mind obviating the very serious and extensive duplication of effort and expense, both to the Government and to the persons to be supervised, if this jurisdiction over the utilities field should be divided between the Securities and Exchange Commission and the Federal Power Commission. It was the purpose of my amendment to center the jurisdiction in one commission in order to avoid such duplication.
>
> I find, however, Mr. Chairman, that at the very end of the bill, on page 292, provision is made for the avoidance of conflicts in jurisdiction, and in reading that section I have reached the conclusion that a large measure of duplication and overlapping can be, and will be, avoided. It was my failure to recall or to notice that at the last moment this section was added to the bill that accounts for my offering the amendment.

79 Cong. Rec. 10507 (1935). Rep. Wadsworth withdrew his amendment, after noting that "[S]ection 318 in large measure meets my objection." *Id.*

The proceedings below produced neither "duplication" nor "overlapping." The SEC applied PUHCA to prevent an abusive change in holding company structure; the creation of SOCCO. The FERC applied the FPA to make a utility—OPCO—operate efficiently by purchasing the cheapest coal on the market. The result conformed to Congress' plan precisely.

D. By Disregarding Congress' Language, the Court of Appeals Weakened the Very Regulatory Tools Congress Meant to Strengthen

The lower court's reading of Section 318 treats OPCO and SOCCO as one "person;" PUHCA treats them as separate companies engaging in an interaffiliate transaction subject to Section 13. This inconsistency invites utilities to use corporate form as a buffer against regula-

tory review. If the SEC's rules are inhospitable, OPCO can escape to FERC by producing the coal itself, thereby eliminating the interaffiliate transactions which trigger PUHCA review. And if FERC is inhospitable, OPCO can return to SEC review by resuming its interaffiliate relationship with SOCCO.

Absent Section 318—as the lower court interpreted it—such gamesmanship would be impossible. But Congress did not enact Section 318, or any other provision in PUHCA, to make regulatory result depend on corporate form. On the contrary:

> [I]t is the substance of what [holding companies] do, and not the form in which they clothe their transactions, which must afford the test. The constitutional authority confided to Congress could not be maintained if it were deemed to depend on the mere modal arrangements of those seeking to escape its exercise.

Electric Bond & Share Co. v. SEC, 303 U.S. 419, 440 (1938) (interpreting Congressional intent in enacting PUHCA).

Before the Court of Appeals decision, FERC was bound to subject interaffiliate transactions to special scrutiny. *See, e.g., Public Service Co. of New Mexico, supra*; *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342, 1348 (4th Cir. 1984). After the Court of Appeals decision, multistate holding companies—precisely those entities whose complex corporate structure and large geographic scope demand special scrutiny—can escape that scrutiny. By enabling these companies to buy goods and services free of competitive pressures, the decision below violates express Congressional intent: the intent to

> eliminate all hidden profits and unfair advantages resulting from the common interests of both parties to the transaction, [and] "to replace them with the checks and balances of free and open competition. . . ."

79 Cong. Rec. 8403, 8438 (1935) (Sen. Wheeler).[8]

The purpose of PUHCA was to restore "effective Federal and State regulation," S. Rep. No. 621, 74th Cong., 1st Sess. at 11 (1935), and to "whittle down the size and power and complication of these giant corporations until the Federal and State commission can be a match for them." 79 Cong. Rec. 9043 (1935) (Sen. Wheeler). FERC's application of the Federal Power Act here—an application which guaranteed "effective Federal . . . regulation," in no way interferes with PUHCA's goal; it complets the task which PUHCA began. *Cf. Baltimore Gas & Electric Co. v. Heintz*, 760 F.2d 1408, 1415 (4th Cir. 1985) (upholding against preemption challenge a state statute prohibiting certain corporate structures permitted by PUHCA), *cert. denied*, 474 U.S. 847 (1985).

The consumer protection authority granted the SEC in Section 13 is incomplete. *See Ohio Power, supra*, 880 F.2d at 1408 ("We note that section 13(b) and the SEC's regulations thereunder do not appear to require submission of and approval of interassociate agreements but only conformity of the same with the SEC-promulgated rules.") But the incompleteness of SEC's authority does not limit FERC's authority. In an analogous context, the

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[8] *See also Report of the National Power Policy Committee*, H.Doc. 137, 74th Cong., 1st Sess. 5 (1935) ("[Holding companies] make profits on the sale of materials to their subsidiaries. . . . These profits and fees, when dictated by the holding company sitting on both sides of the transaction, in no wise represent bargains freely and openly arrived at by subsidiary companies on the basis of the lowest cost in a competitive market."); 79 Cong. Rec. 10652 (1935) (Rep. Sauthoff) ("It was a very common practice not to have any competitive bidding in making purchases of supplies, equipment, or material of any kind. By not having competitive bidding it was possible to charge the operating company an excessive price and pocket the difference.").

Fourth Circuit ruled that Congress' failure to ban certain holding company structures does not preclude states from doing so. *See Baltimore Gas & Electric Co., supra*, 760 F.2d at 1414-15. Similarly, Congress' decision to authorize the SEC to regulate only the nonutility seller does not mean FERC cannot regulate the utility buyer.

II. THERE ARE NO "TRAPPED COSTS" BECAUSE THE SEC NEVER DIRECTED OPCO TO PURCHASE COAL FROM SOCCO

Properly read, Section 318 provides a solution to this case which is simple, logical and consistent with Congress' dual regulatory scheme. Once this Court finds that OPCO and SOCCO are not the same "person," it need go no further.

The Court of Appeals did go further, because it ignored Congress' clear language. The lower court explained that its "subject matter" holding was "informed" and "buttressed" by the "trapped costs" analysis of *Nantahala Power & Light v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). 880 F.2d at 1409-10. As we explain below, the "trapped cost" findings in *Nantahala* and *Mississippi Power & Light* have no application to the instant case.

A. In Nantahala and Mississippi, the Agency Directed the Buyer to Purchase From Its Affiliate; The Buyer Had No Legal Right to Buy From Other Sources

In *Nantahala* and *Mississippi*, the "trapping" took place because one agency (FERC) ordered a utility to take a certain action; then another agency (a state commission) set the utility's rates as if the utility had taken an entirely different action. The *Nantahala* Court explained this point clearly:

> Nantahala could not have treated itself as having access to any more low-cost entitlement power than it is eligible to include under FERC's interpretation of what would be a fair allocation. *No source of power besides entitlement and purchased power from TVA is said to be available to Nantahala.*

476 U.S. at 973 (emphasis added). And the *Mississippi* Court further explained (487 U.S. at ——, 101 L.Ed.2d 322 at 339) (emphasis added):

> *Nantahala* involved a FERC order fixing the utility's right to acquire low cost power; this case [*i.e.*, *Mississippi*] involves a FERC order fixing MP&L's obligation to acquire high cost power. . . . [I]n this case FERC has determined that MP&L's cost of power obtained from Grand Gulf should be based on a particular allocation, and no other. In *Nantahala* the state court attempted to approve retail rates based on the assumption that Nantahala was entitled to more low cost power than FERC had allocated to it. Here the state court seeks to permit the State to set rates based on an assumption that *MP&L is obligated to purchase* less Grand Gulf power than FERC has ordered it to purchase.

Put another way, in *Nantahala* and *Mississippi Power & Light*, the buying utility had no legal mind of its own; yet the state commissions treated the utility as having the ability to shop for alternative power:

> [I]t obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that *FERC has ordered it to pay for*. Just as Nantahala had no legal right to obtain any more low cost TVA power than the amount allocated by FERC, it is equally clear that MP&L may not pay for less Grand Gulf power than the amount allocated by FERC.

487 U.S. at ——, 101 L.Ed.2d at 339-40 (emphasis added).

B. OPCO Volunteered to Buy From SOCCO; and the SEC Did Not and Could Not Direct the Purchase

The facts here are fundamentally different from those in *Nantahala* and *Mississippi*. No agency obligated OPCO to buy from SOCCO. In *Nantahala* and *Mississippi*, the first step toward cost-trapping occurred when an agency ordered the utility to buy from its affiliate. Here the buyer initiated the plan. OPCO sought SEC permission in 1971 to acquire additional SOCCO stock to finance a coal mining venture in Ohio. *The entire OPCO-SOCCO scheme was voluntary.* The "trapped cost" argument does not apply, for the simple reason that there is no "trap."

Moreover, the approval OPCO sought was not for OPCO to buy coal from SOCCO; the approval was for SOCCO to sell coal to AEP's utility subsidiaries. The SEC noted that SOCCO would sell "at cost." But the SEC did not order SOCCO to sell at that price (or at any price); nor did the SEC order OPCO to buy at that price (or at any price). There is no SEC order even approving an OPCO purchase, much less ordering an OPCO purchase. Respondent's description of OPCO's coal costs as "costs which [OPCO] is obligated to pay pursuant to the SEC's order," Juris. Br. at 2, is false.

Even if the SEC had ordered OPCO's purchase, that order would not negate OPCO's voluntarism. In *Mississippi Power & Light*, *supra*, the holding company, through an agreement enforced by FERC (after modification), compelled the operating utilities to participate in the systemwide plan. *See* 487 U.S. at ——, 101 L.Ed.2d at 341 ("'[i]mplementation of the System plan . . . require[d] that the individual companies' needs be subsumed by the greater interests of the entire System'") (*quoting* underlying FERC decision). In the instant case, there is no sign of holding company participation. AEP was not even a moving party in any of the four SEC proceedings at issue here.

The SEC did not order OPCO's purchase for another reason: the SEC has no authority to do so. No provision of Section 13 or any other section of PUHCA applies to a utility *buying* goods from an affiliate or associate. Section 13(a) applies to "any registered holding company." Section 13(b) applies to "any subsidiary company of any registered holding company [which] . . . undertakes to . . . *sell* goods to . . . any associate company." Section 13(d) deals with "mutual service companies." Section 13(e) applies to "any affiliate of any public-utility company [which] . . . undertakes to . . . *sell* goods to . . . any such company of which it is an affiliate." Section 13(f) applies to "any person whose principal business is the *performance of* service, sales or construction contracts for public-utility or holding companies." These provisions have nothing to do with ordering a purchase.[9] Ordering a purchase would be regulating operations, a matter Congress entrusted to FERC. *See City of Lafayette*, *supra*.

The SEC approved a corporate relationship and nothing more. That approval *permitted* SOCCO to sell coal to the AEP subsidiaries (such permission being required by Section 13(b)). There was no "trap" created by inconsistent regulatory decisions. OPCO's decision to buy SOCCO's coal was OPCO's decision alone.

---

[9] Section 13(c) is a general provision describing the types of regulations and orders the SEC may prescribe "under this Section" (*i.e.*, Section 13). Since no other provision of "this Section" authorizes the SEC to order OPCO's purchase, Section 13(c) cannot do so. Section 13(g) requires the SEC to conduct general industry investigations and report to Congress. Neither Section 13(c) nor Section 13(g) imposes any obligation on OPCO.

CONCLUSION

The Court of Appeals decision should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1989

ARCADIA, OHIO, ET AL., PETITIONERS

v.

OHIO POWER COMPANY, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION AS RESPONDENT SUPPORTING PETITIONERS AND FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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QUESTION PRESENTED

Whether Section 318 of the Federal Power Act (16 U.S.C. 825q), which governs "Conflict of jurisdiction" between the Federal Energy Regulatory Commission (FERC) and the Securities and Exchange Commission (SEC), precludes FERC jurisdiction whenever the FERC and the SEC have jurisdiction to regulate the same subject matter, or only when there is an actual conflict between a requirement of the FERC and a requirement of the SEC.

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S. Rep. No. 621, 74th Cong., 1st Sess. (1935) 4, 7, 24

In the Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1283

ARCADIA, OHIO, ET AL., PETITIONERS

v.

OHIO POWER COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION AS RESPONDENT SUPPORTING PETITIONERS AND FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-28a) is reported at 880 F.2d 1400. The pertinent orders of FERC (Pet. App. 31a-67a, 68a-73a) are reported at 39 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,098 and 43 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,046.

JURISDICTION

The court of appeals entered its judgment on July 28, 1989. Rehearing petitions filed by FERC and petitioners were denied on October 12, 1989 (Pet. App. 29a-30a). The petition for a writ of certiorari was filed on February 9, 1990. The Court granted certiorari on March 26, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 318 of the Federal Power Act (enacted as Section 213 of the Public Utility Act of 1935), 16 U.S.C. 825q, provides:

> **Conflict of jurisdiction.** If, with respect to the issue, sale, or guaranty of a security, or assumption of obligation or liability in respect of a security, the method of keeping accounts, the filing of reports, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 [15 U.S.C. 79 *et seq.*] or of a rule, regulation, or order thereunder and to a requirement of this chapter or of a rule, regulation, or order thereunder, the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this chapter, or any rule, regulation, or order thereunder, with respect to the same subject matter, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this chapter shall apply to such person.

STATEMENT

This case involves the circumstances under which Section 318 of the Federal Power Act ousts FERC of jurisdiction to regulate public utilities that are also regulated by the SEC under the Public Utility Holding Company Act. FERC and the SEC support petitioners in their view that the court of appeals' interpretation of Section 318 improperly limits the regulatory jurisdiction of FERC.

1. The Public Utility Act of 1935, ch. 687, 49 Stat. 803, included two separate but overlapping pieces of legislation.[1] Title I, the Public Utility Holding Company Act (PUHCA), 15 U.S.C. 79 *et seq.*, entrusts the Securities and Exchange Commission with regulation of the corporate structure and financing of public utility holding companies and their affiliates. At the same time, Title II, which is designated Parts II and III of the Federal Power Act (FPA), 16 U.S.C. 824 *et seq.*, entrusts the Federal Energy Regulatory Commission with regulation of the wholesale sale of electricity by electric utilities in interstate commerce.

The Public Utility Act had "two primary and related purposes: to curb abusive practices of public utility companies by bringing them under effective control, and to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce." *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 758 (1973). The first purpose arose in response to widespread abuses by holding companies and their subsidiaries, including: (1) the issuance of securities to the public that were based on unsound asset values or on paper profits from intercompany transactions, which prevented investors from obtaining accurate financial information; (2) the subjection of operating subsidiaries of holding companies to unreasonable charges under service, construction, or sales contracts that were not based on arm's-length dealing or otherwise constrained by competition; and (3) the extension of holding company ownership

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[1] For the history of the consolidation of the two statutes into what ultimately became the Public Utility Act of 1935, see DeVane, *Highlights of Legislative History of the Federal Power Act of 1935 and the Natural Gas Act of 1938*, 14 Geo. Wash. L. Rev. 30, 37 (1945).

to disparate, unintegrated operating utilities throughout the country without regard to economic efficiency or coordination of managment. See Section 1(b) of PUHCA, 15 U.S.C. 79a(b).[2]

The second aim of the Public Utility Act – to provide effective regulatory control over the transmission and sale of electric energy in interstate commerce – arose in response to a gap in state regulation of utility rates and services that developed in the wake of this Court's decision in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83, 86-90 (1927). The Court in *Attleboro* held that interstate wholesale sales of electricity were beyond the reach of state regulators. This holding created a regulatory gap: the States could not regulate interstate wholesale suppliers of electricity and, although the federal government had the constitutional power to regulate in this area, there was no federal agency with statutory authority to do so.[3]

[2] As this Court noted in *North American Co.* v. *SEC*, 327 U.S. 686, 701 n.11 (1946), "[t]he congressional findings as to abuses listed in § 1(b) [of PUHCA] were based upon some of the most exhaustive and comprehensive studies ever to underlie a federal statute." Among these studies were the 101-volume report of the Federal Trade Commission and an extensive investigation by a House of Representatives committee that disclosed a number of abuses related to the "pyramiding" of control of operating public utilities through holding companies. See *Utility Corporations*, S. Doc. No. 92, 70th Cong., 1st Sess. (1928); *Report on the Relation of Holding Companies to Operating Companies in Power and Gas Affecting Control*, H.R. Rep. No. 827, 73d Cong., 2d Sess. (1934). Both reports are expressly referred to in PUHCA Section 1(b). See generally 1L. Loss, *Securities Regulation* 131-143 (2d ed. 1961).

[3] S. Rep. No. 621, 74th Cong., 1st Sess. 17 (1935); H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7-8 (1935). The general trend in this Court's modern Commerce Clause jurisprudence has moved away from the mechanical line drawing applied in *Attleboro*. See *Arkansas Electric Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377-380, 390-393 (1983).

2. a. At the core of PUHCA were the requirements of Section 5, 15 U.S.C. 79e, that holding companies with operating utility subsidiaries register with the SEC, and of Section 11, 15 U.S.C. 79k, that each registered holding company comply with stringent geographical integration and corporate simplification requirements.[4] Thus, although the statute did not eliminate holding companies altogether, each holding company that survived regulatory scrutiny would be limited to operation of a single integrated utility system, doing business in a single area or region and possessing a relatively simple capital structure.

Other provisions of PUHCA provided that the SEC was to maintain control over the financing and structure of holding companies and their affiliates. PUHCA therefore granted the SEC detailed authority over, *inter alia*, the issuance of securities by holding companies or their subsidiaries (Sections 6 and 7, 15 U.S.C. 79f, 79g); acquisition by holding companies or their affiliates of securities, utility assets, or any interests in any other business (Sections 9 and 10, 15 U.S.C. 79i, 79j); and accounting and record-keeping functions of holding companies and their affiliates (Sections 15 and 20, 15 U.S.C. 79*o*, 79t).

A principal aim of PUHCA was to protect investors and consumers by preventing holding companies and their subsidiaries from paying or receiving unjustified prices for goods or services due to "an absence of arm's-length bargaining or from restraint of free and independent competition." 15 U.S.C. 79a(b)(2). To this end, Section 13(a) of PUHCA, 15 U.S.C. 79m(a), prohibited any registered holding company from contracting for services, sales, or construction with an associated public utility or mutual

[4] The term "holding company" will be used in this brief to refer to public utility holding companies registered under Section 5 of PUHCA, 15 U.S.C. 79e.

service company. In addition, Section 13(b), 15 U.S.C. 79m(b), made it unlawful for subsidiaries of a holding company to contract with associated companies except in accordance with SEC regulation. The SEC was to oversee such contracts "as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies." 15 U.S.C. 79m(b).

b. The primary purpose of the FPA was to fill the "*Attleboro* gap" by authorizing the FPC—now FERC [5]—to regulate wholesale electric rates charged by public utility operating companies in interstate commerce. 16 U.S.C. 824, 824d. See *Jersey Central Power & Light Co.* v. *FPC*, 319 U.S. 61, 67-68 & n.7 (1943). The legislation required utilities to file their rate schedules with FERC and authorized FERC to suspend any rate increase for up to five months, order refunds for rates it finds exceed a "just and reasonable" level, and prescribe rates to be charged prospectively. See Sections 205(e), 206(a), 16 U.S.C. 824d(e), 824e(a).

To assure effective regulation, Congress conferred certain additional powers on FERC. For example, it is unlawful for a public utility to "sell, lease, or otherwise dispose of" its facilities, or to "purchase, acquire, or take any security of any other public utility" without FERC approval (Section 203 of the FPA, 16 U.S.C. 824b). It is also unlawful for any public utility to issue securities or assume debts or other obligations without FERC authorization (§ 204, 16 U.S.C. 824c). In addition, Section 301, 16

[5] The Act designated the Federal Power Commission to administer its provisions. On October 1, 1977, the FPC ceased to exist and its functions were transferred to FERC and the Secretary of Energy pursuant to provisions of the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 and Exec. Order No. 12,009, 42 Fed. Reg. 46,267 (1977).

U.S.C. 825, requires public utilities to keep accounts and records as required by FERC, and authorizes FERC to prescribe a system of accounts for that purpose.

c. The powers over public utilities granted to the FPC overlapped to some extent the powers granted to the SEC to regulate holding companies and their affiliates. Therefore Congress included Section 318 of the FPA, 16 U.S.C. 825q, to govern conflicts arising between the two agencies. See, *e.g.*, H.R. Rep. No. 1318, 74th Cong., 1st Sess. 35 (1935); S. Rep. No. 621, 74th Cong., 1st Sess. 54 (1935). Section 318, entitled "Conflict of jurisdiction," provides that where a company is subject to a PUHCA-based SEC requirement and an FPA-based FERC requirement, the SEC's requirements will be given controlling effect.

3. This case arose out of a rate filing that Ohio Power Company, an operating utility subsidiary within the American Electric Power Company, Inc. holding company system, made with FERC in 1982. Pursuant to Section 205 of the FPA, 16 U.S.C. 824d, Ohio Power sought to increase its rates for wholesale service to its ratepayers, including the petitioner municipalities. Litigation before FERC ensued concerning whether and to what extent Ohio Power was entitled to recover the price it had paid for coal to its wholly owned mining subsidiary, the Southern Ohio Coal Company (SOCCO), pursuant to the terms of a contract between Ohio Power and SOCCO.

a. In 1971, Ohio Power, as part of the American Electric Power system sought SEC approval under PUHCA of a series of transactions that would permit it to establish SOCCO as a coal-mining subsidiary. Under Ohio Power's proposal, SOCCO was to develop and mine various reserves of coal owned by Ohio Power, and thus assure a reliable supply for certain Ohio Power generating units then under construction. The SEC noted that under the

proposal before it, "[t]he charges for coal by [SOCCO] * * * will be based on an amount equal to the actual cost of [SOCCO] in developing the reserve and mining such coal, including all appropriate overheads and interest charges and including a reasonable rate of return on Ohio Power's equity investment in [SOCCO]." *In re Ohio Power Co.*, HCAR No. 17383, (Dec. 2, 1971), J.A. 79. The SEC approved the transactions, and in three subsequent orders authorizing further financing for SOCCO's mining operations, specified that the price at which SOCCO sold coal to Ohio Power could "not exceed the cost" to SOCCO. *In re Ohio Power Co.*, HCAR No. 20515, 14 SEC Dkt. 928 (Apr. 24, 1978), J.A. 79; *In re Southern Ohio Coal Co.*, HCAR No. 21008, 17 SEC Dkt. 310, 312 (Apr. 17, 1979), J.A. 85; *In re Southern Ohio Coal Co.*, HCAR No. 21537, 19 SEC Dkt. 1309, 1309 (Apr. 25, 1980), J.A. 93.

b. In the proceedings before FERC arising from Ohio Power's 1982 rate-increase application, Ohio Power contended that the SEC had approved its plan to purchase the coal "at cost" from SOCCO. According to Ohio Power, this meant that FERC was barred by Section 318 of the FPA from prohibiting the pass-through in rates of any part of the price Ohio Power had paid its subsidiary for the coal.

Following an investigation initiated by FERC under Sections 205 and 206 of the FPA, 16 U.S.C. 824d, 824e, FERC concluded that Section 318 did not bar it from reviewing and prohibiting the pass-through of any excessive payment Ohio Power had made to its affiliate SOCCO for the "captive" coal on the ground that the rates reflecting such excessive payments would not be "just and reasonable" under the FPA. Pet. App. 31a-67a. As FERC viewed it, while PUHCA authorized the SEC to regulate the intra-

corporate price of coal between Ohio Power and its subsidiary, that statute did not bar FERC—operating under a statutory mandate to protect ratepayers from excessive rates—from prohibiting the pass-through of any portion of a utility's coal costs that led to rates that were not "just and reasonable" in light of market conditions. Pet. App. 34a-40a. FERC found this approach particularly warranted in this case, since the evidence showed that Ohio Power had paid SOCCO about 25-33% over prevailing market prices for the coal it purchased during the period from 1982-1986. Pet. App. 58a-59a.[6] FERC therefore ordered Ohio Power to refund to ratepayers the difference between the market price and the higher amount it actually paid SOCCO. Ohio Power's petition for rehearing was denied. Pet. App. 68a-73a.

4. a. A panel of the D.C. Circuit vacated FERC's order, with one judge concurring only in the judgment. The majority first determined that since Congress had designed Section 318 to allocate jurisdiction between FERC and the SEC, Section 318 could not be deemed "entrusted to FERC's administration" and therefore FERC's interpretation of that provision was entitled to no deference. Pet. App. 8a. The court then held that at least one prerequisite to application of Section 318—regulation of the "same subject matter" by both the SEC and FERC—was met in this case. The court held that in regulating the price term in the coal contract between Ohio Power and SOCCO, the SEC was regulating the "same subject matter" as was regulated when FERC determined the appropriate price for the same coal for ratemaking purposes. Pet. App. 9a-13a. The court supported this conclusion by

[6] FERC also found that Ohio Power had paid SOCCO "50% above market in 1980 [and] 94% [above market] in 1981," the two years before the initiation of proceedings before FERC. Pet. App. 58a.

observing that the purposes underlying SEC and FERC jurisdiction in this area were similar (Pet. App. 10a-11a), and rejected FERC's contention that SEC disclaimers of ratemaking authority were relevant. Pet. App. 11a-13a. See note 15, *infra*.

FERC argued that it was not ousted of jurisdiction under Section 318 because the statute required an actual conflict between FERC and SEC "requirements" before the rule of SEC precedence would take effect. According to FERC, the SEC itself recognized that inter-affiliate contracts under Section 13(b) of PUHCA, 15 U.S.C. 79m(b), could in some circumstances be based on market price, rather than cost. See 17 C.F.R. 250.92 (seller-produced goods may be sold to holding company affiliate at no greater than market price). Moreover, FERC argued that the four SEC orders addressing the Ohio Power-SOCCO arrangement had set cost as an upper limit to the price that SOCCO could charge for coal, but did not impose any "requirement" as to the exact price that should be paid. Thus, according to FERC, its market price rule—which on the facts of this case resulted in a coal price lower than cost—did not conflict with the SEC orders or any other SEC regulatory action. See Pet. App. 14a.

The court of appeals rejected FERC's argument "because it proceeds from a false premise that the bar of Section 318 applies only when there is a present conflict between SEC and FERC prescriptions." Pet. App. 14a. According to the court, Section 13(b) of PUHCA subjected Ohio Power to PUHCA-based "requirements" concerning the coal contract with SOCCO, even aside from the four SEC orders. The court held that, in light of Section 318, this alone established that "[i]n the absence of exemption, it is for the SEC rather than FERC to determine the inter-associate price." Pet. App. 14a.

The court thus did not decide whether the SEC orders required that SOCCO sell the coal to Ohio Power at cost, or instead merely set cost as a ceiling. Rather, the court rested its decision "on the threshold matter of the language of the statute, which commits the determination of the inter-associate price to the SEC." Pet. App. 15a-16a. The court observed, however, that its reading of the statute was "informed" by the possibility that Ohio Power would be subject to "trapped costs" if both the FERC and SEC actions were valid. Pet. App. 16a.

b. In an opinion concurring in the judgment, Judge Mikva disagreed with the majority's interpretation of Section 318. He noted that Section 318 speaks in terms of conflicting FERC and SEC "requirements," and that therefore FERC is divested of jurisdiction under Section 318 only where "requirements" the SEC and FERC impose are "in actual conflict." Pet. App. 19a-22a. Because, in Judge Mikva's view, "the SEC's orders * * * permit Ohio Power to pay less than cost for coal, FERC's imposition of a market price less than cost does not in this case create a jurisdictional conflict." Pet. App. 23a.

Judge Mikva nonetheless agreed with the majority that the FERC order had to be vacated. In his view, FERC's Rule 35.14(a)(7) (18 C.F.R. 35.14(a)(7)) barred FERC from imposing a market-price test.[7] Pet. App. 23a-28a. In discussing Rule 35.14(a)(7) in its own decision, FERC had held that it merely "creates a presumption of reasonableness, not a conclusive finding of reasonableness" with respect to pricing at cost. Pet. App. 41a. The majority did not reach the issue of the meaning of Rule 35.14(a)(7).

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[7] Rule 35.14(a)(7) provides in pertinent part:

> Where the utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and includable in the adjustment clause.

c. The court of appeals denied petitions for rehearing and suggestions for rehearing *en banc* filed by FERC and petitioners. Pet. App. 29a. Noting that he would have granted the petition for rehearing by the panel, Judge Mikva filed a statement reemphasizing his view that "the statutory interpretation engaged in by the majority * * * generates a no-man's land where neither the [SEC] nor FERC will patrol holding company practices which can oppress consumers, investors and the public." Pet. App. 30a.

SUMMARY OF ARGUMENT

The Federal Power Act gives FERC regulatory jurisdiction over firms involved in the interstate wholesale sale of electricity. The Public Utility Holding Company Act gives the SEC jurisdiction to regulate firms organized as public utility holding companies and their utility and non-utility subsidiaries. Some firms involved in the interstate wholesale sale of electricity are subsidiaries of public utility holding companies, and are therefore subject to regulation by both FERC and the SEC. Section 318 of the FPA, the statute at issue in this case, governs the terms on which FERC's regulatory jurisdiction co-exists with that of the SEC.

Both the SEC and FERC agree that the court of appeals erred in interpreting Section 318 to oust FERC of jurisdiction in an area whenever the SEC in administering PUHCA has imposed some regulation in that area. Instead, the agencies take the position that Section 318, along with several provisions of PUHCA, allow substantial room for concurrent, consistent regulation. Section 318's rule of SEC precedence takes effect only when regulations or orders adopted under PUHCA and the FPA create conflicting obligations for regulated entities.

In considering the merits of this position, the view of both the SEC and FERC that Section 318 permits concurrent, consistent regulation is entitled to substantial deference. This interpretation can be traced back to positions that the SEC has taken since at least 1944, only nine years after the FPA and PUHCA were enacted. Particularly because the purpose of Section 318 is to resolve questions of jurisdiction between the SEC and FERC, the fact that the two affected agencies agree on how Section 318 is to be interpreted should be dispositive unless it is inconsistent with the terms of the statute.

Far from being inconsistent with the terms of the statute, the view that a regulated entity must obey both FPA-based and PUHCA-based regulation in the absence of an actual conflict is embodied in Section 318 itself, which appears under the heading "Conflict of jurisdiction" and takes effect only where an entity is subject to "requirements" imposed under both PUHCA and the FPA. When the statute was enacted, Section 318 was repeatedly explained as addressing the problem created by "conflicts" between the two agencies. In the only judicial decisions construing Section 318, this Court and the courts of appeals have looked to the existence of an actual conflict between the requirements imposed by FERC and the SEC to determine whether Section 318 is triggered.

Moreover, the statutory purposes of the FPA and PUHCA would be disserved by the interpretation advanced by the majority below. Before adopting its sweeping "field preemption" analysis, the court of appeals should have considered more carefully the differing expertise and regulatory missions of the two agencies in this case. Whereas the SEC's expertise and mission center on the analysis of financial structure, capital formation, and fraud prevention, the mission and expertise of FERC are

focused on engineering and ratemaking. To oust FERC of jurisdiction just because the SEC has taken some action – or perhaps even if the SEC has authority to take some action – threatens to create regulatory "gaps" and to thwart the goals of the FPA. Therefore, although the SEC plainly is entitled to precedence under Section 318 when its regulations conflict with those of FERC, requirements imposed by both agencies should be given full effect in cases in which they pose no actual conflict.

ARGUMENT

SECTION 318 OF THE FEDERAL POWER ACT OUSTS FERC OF ITS AUTHORITY UNDER THAT ACT ONLY WHEN THE EXERCISE OF THAT AUTHORITY ACTUALLY CONFLICTS WITH ACTION TAKEN BY THE SEC IN ITS ENFORCEMENT OF THE PUBLIC UTILITY HOLDING COMPANY ACT.

A. The Long-Standing Interpretation By Both The SEC And FERC Requiring Actual Conflict Before Section 318 Ousts FERC Of Jurisdiction Is Entitled To Substantial Deference

Section 318 does not oust FERC of regulatory jurisdiction in the absence of an actual conflict between requirements imposed by FERC and those imposed by the SEC. This interpretation was advocated by the SEC as long ago as 1944, a mere nine years after PUHCA and the FPA were enacted. It has been consistently recognized by FERC as well. Therefore, as an interpretation by the agencies entrusted with administration of the statutes involved, it is entitled to substantial deference. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

1. In *Northwestern Electric Co. v. FPC*, 321 U.S. 119 (1944), the authority of the FPC to impose a particular accounting requirement on a regulated interstate seller of electric power was challenged under Section 318, since the utility was also a subsidiary of a registered holding company and therefore subject to the SEC's authority to im-

pose accounting requirements pursuant to Section 15 of PUHCA, 15 U.S.C. 79*o*. In connection with the litigation, the SEC was asked its views concerning the interpretation of Section 318. The SEC responded, in a letter from Chairman Purcell that was appended to the brief for the government. Since the views expressed in the letter have remained the SEC's consistent position for nearly a half century, they are worth quoting at some length:

> Section 318 of the Public Utility Act of 1935 resolves the question of possible conflicting requirements of the Public Utility Holding Company Act of 1935 and rules, regulations, and orders thereunder with the Federal Power Act and rules, regulations and orders thereunder by providing that in case of conflict the requirements of the former Act shall prevail. Not all of the provisions of the Public Utility Holding Company Act of 1935 are self-operative, however; and in the absence of rules, regulations or orders of the S.E.C. implementing such provisions of that Act, these provisions neither compel nor prohibit any action. Until the S.E.C. does by rule or order impose "requirements" pursuant to the sections which are not self-operative, there can be no conflict of requirements and Sec. 318 does not apply. It was not intended that utility companies should be able to thwart regulation by the F.P.C. by conjuring up under Sec. 318 imaginary conflicts with *potential* action of the S.E.C.
>
> * * * In our view no action taken by the S.E.C. applicable to Petitioner Northwestern conflicts with the action of the F.P.C. in the case under review.

Resp. Br. App. D, at 98-99, *Northwestern Electric Co. v. FPC*, 321 U.S. 119 (1944).

Northwestern Electric involved acounting requirements of the SEC and the FPC, not regulation of inter-affiliate purchases as in this case. In discussing the specific application of Section 318 to the facts of the case, the SEC noted that "[w]hile the S.E.C. has exercised no accounting jurisdiction with respect to Northwestern, it does sometimes deal with accounting questions in connection with companies which are also subject to F.P.C. jurisdiction." Resp. Br. App. D, at 101. In the view of the SEC, however, "this exercise of accounting jurisdiction is not inconsistent with subsequent or concurrent accounting regulation of the same company by the F.P.C., and does not *per se* make Sec. 318 applicable." *Id.* at 102. The conclusion to be drawn was that "[t]his dual accounting regulation * * * has sound pragmatic justification, and is not inconsistent with the purpose of Sec. 318." *Ibid.*

The position advocated in the SEC's letter is essentially the position we urge in this case. In the absence of an SEC action taken under PUHCA that "compel[s] [ ]or prohibit[s]" some action by a regulated entity, the entity cannot be said to be subject to any "requirement" under PUHCA. Therefore, there is no "conflict" of "requirements" that requires resolution by reference to Section 318; regulation by both agencies that is "consistent" and "concurrent" is fully in accord with the intent of Section 318, the balance of the FPA, and PUHCA.

The SEC adopted the above view shortly after enactment of the Public Utility Act of 1935, which contains both the PUHCA and the FPA. As a nearly "contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new," *Udall* v. *Tallman*, 380 U.S.

1, 16 (1965), this understanding is entitled to substantial weight.[8] Accord *Aluminum Co. of America* v. *Central Lincoln Peoples' Utility Dist.*, 467 U.S. 380, 389-390 (1984); *E.I. du Pont de Nemours & Co.* v. *Collins*, 432 U.S. 46, 54-55 (1977); *United States* v. *National Ass'n of Securities Dealers, Inc.*, 422 U.S. 694, 719 (1975). Moreover, although the SEC has rarely had occasion formally to address the relationship between PUHCA and the FPA since that time, it has continued to adhere to this view when the issue has arisen.

For example, in *Appalachian Elec. Power Co.*, 27 S.E.C. 1029 (1948), the SEC approved, *inter alia*, the formation of a new holding company subsidiary to operate a generating plant on behalf of two of the holding company's other operating subsidiaries. The SEC noted, however, that its approval of the arrangement did not divest FERC of jurisdiction over the terms of the contract for sale of the power to be generated by the plant. *Id.* at 1035. The SEC "regard[ed] [the terms of the contract] as a matter to be determined primarily by the regulatory authorities having jurisdiction over the rates and accounts of the companies concerned." *Ibid.* To be sure, the SEC retained the ability "to determine at a later date whether the actual operation of the contract in any way contravenes the standards of the Holding Company Act." *Ibid.* Nonetheless, unless and until the SEC so determined, FERC was not ousted of regulatory jurisdiction over aspects of the same transaction.

2. FERC and its predecessor also have interpreted Section 318 to give the SEC regulatory action precedence only in cases of actual conflict with FERC regulation. In the case at hand, FERC noted that, if the four SEC orders ap-

[8] It should be noted that PUHCA has remained virtually unchanged since its passage in 1935.

proving the Ohio Power-SOCCO arrangement were interpreted to set only a ceiling price for Ohio Power's coal purchases, the actual price below that ceiling would remain subject to FERC regulation. Pet. App. 34a-35a. Thus, although the discussion is phrased in terms of whether the SEC and FERC regulate the same "subject matter," FERC's interpretation of Section 318 is that both agencies retain concurrent, consistent regulatory jurisdiction in the absence of conflicting requirements. FERC has recently taken the same position in a number of other cases. See, *e.g.*, *Savannah Elec. & Power Co.*, 42 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,340, at 61,779 (1988) (Section 318 requires a "direct conflict"); *Central Illinois Public Serv. Co.*, 42 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,073, at 61,327 (1988) (same).

The roots of FERC's "actual conflict" position date back to just after enactment of the FPA.[9] In *In re George B. Evans*, 1 F.P.C. 511, 515-516 (1937), the SEC had approved the purchase of utility assets by a holding company, as well as the issuance of securities and other aspects of a complex transaction attendant upon a utility bankruptcy. The FPC recognized that it had no jurisdiction under Section 318 over those particular aspects of the transaction that the SEC had approved. *Id.* at 515. Nonetheless, the FPC continued to exercise jurisdiction under Section 203 of the FPA, 16 U.S.C. 824b, over the sale of

[9] The fact that FERC has only recently fully articulated its view of Section 318 does not affect the deference due that interpretation. An agency's current policy "is entitled to deference even if it represents a departure from [the agency's] prior policy." *NLRB* v. *Curtin Matheson Scientific, Inc.*, 110 S. Ct. 1542, 1549 (1990). In *Chevron* itself the fact that the agency had recently modified its interpretation did not alter the Court's conclusion that its new view was entitled to deference. 467 U.S. at 853-859. Here, FERC has not changed any prior position in articulating its interpretation of Section 318; deference to its view is therefore entirely apt.

the same utility assets. 1 F.P.C. at 515-516. Although the FPC did not articulate a particular interpretation of Section 318, its actions are fully consistent with an actual conflict analysis and inconsistent with a broad field preemption theory. See also *In re Olcott Falls Co.*, 3 F.P.C. 310, 312 (1942).

3. Nothing in this case alters the rule that an administrative construction of a statute entrusted to an agency must be accepted by the courts so long as it is reasonable and does not violate the plain terms of the statute. *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-844 (1984).[10] The fact that Section 318 could be characterized as a "jurisdictional" statute does not affect the legitimacy of the FERC-SEC interpretation. *Mississippi Power & Light Co.* v. *Mississippi*, 487 U.S. 354, 381 (1988) (Scalia, J., concurring in the judgment) ("[I]t is settled law that the rule of deference applies even to an agency's interpretation of its own statutory authority or jurisdiction."); see also *Dole* v. *United Steelworkers*, 110 S. Ct. 929, 944 (1990) (White, J., dissenting).[11] Where Congress has granted agencies broad

[10] Although FERC itself did not argue below that its interpretation of the statute was entitled to *Chevron* deference, the court of appeals considered this contention (Pet. App. 8a) and rejected it, and the petition for certiorari raised the deference issue as the first question presented. Therefore, even assuming *arguendo* that the deference argument is correctly tested by the rule that issues not raised or considered in the court of appeals will ordinarily not be considered by this Court, see *Delta Air Lines, Inc.* v. *August*, 450 U.S. 346, 362 (1981); *Adickes* v. *Kress & Co.*, 398 U.S. 144, 147 n.2 (1970), that rule does not apply to this case. Cf. *On Lee* v. *United States*, 343 U.S. 747, 749-750 n.3 (1952) (although court of appeals would have been within its discretion in refusing to consider point not preserved for appeal, "their having passed on it leads us to treat the merits also").

[11] The court of appeals held (Pet. App. 8a) that the FERC construction of the statute was not entitled to deference because "Section 318 cannot be said to be entrusted to FERC's administration." The court

powers to regulate an industry, as in the FPA and PUHCA, it is reasonable to assume that it left the resolution of jurisdictional as well as non-jurisdictional ambiguities to the agencies that must face the pragmatic issues involved in achieving the congressional purpose. *City of New York* v. *FCC*, 486 U.S. 57, 64 (1988); *NLRB* v. *City Disposal Systems, Inc.*, 465 U.S. 822, 830 n.7 (1984); see also *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 844-845 (1986); *Chemical Manufacturers Ass'n* v. *Natural Resources Defense Council, Inc.*, 470 U.S. 116, 123, 125-126 (1985). In addition, the considerations of agency expertise that ordinarily support deference are fully applicable to this case. It is the SEC and FERC – and not the courts – that would be most aware if a broad field pre-emption rule were necessary to achieve the statutory goals of the FPA and PUHCA. Conversely, it is the SEC and FERC that would be most acutely aware of regulatory gaps that could be created by unnecessarily curtailing FERC's authority.

Even if only limited deference to agency interpretations of "ordinary" jurisdictional statutes were appropriate, see *Mississippi Power & Light Co.*, 487 U.S. at 383 (Brennan, J., dissenting), the joint position of the SEC and FERC with respect to a statute that allocates jurisdiction between them would still be entitled to substantial deference. Any concern that an agency's "institutional interests in expanding its own power" would lead it to interpret a jurisdictional statute too broadly is highly attenuated here. *Id.* at 387. First, Section 318 does not limit the reach of federal regulation of the utility industry, and no policy in favor of such limitation is discernible in its language or legislative

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of appeals may have been unaware, at least until the petition for rehearing in this case, see FERC Pet. for Reh'g 7, that the SEC had adopted the same construction in the *Northwestern Electric* case in 1944, as discussed above.

history. Because any interpretation of Section 318 would therefore simply allocate federal regulatory responsibilities, this case raises no issues concerning the expansion of federal power by agency action into areas Congress intended to leave free of federal regulation. Second, because Section 318 allocates jurisdiction between two agencies, the fact that they agree on an interpretation of the statute strongly suggests that neither agency is bent on expanding its jurisdiction unduly.

B. The Language, Structure And Legislative History Of Section 318 Make Clear That FERC's Authority Is Precluded Only When Its Regulation Actually Conflicts With SEC Regulation

The long-standing view of the SEC and FERC that Section 318's rule of SEC precedence is triggered only in the event of an actual conflict is not only a permissible construction of the statute; it is the most compelling interpretation. The language and legislative history of Section 318 both point to the need for an actual conflict in requirements before the rule of SEC precedence takes effect. This conclusion is supported by consideration of related provisions in PUHCA that also allocate regulatory jurisdiction over utility subsidiaries of holding companies. Moreover, the actual conflict analysis has been applied in the only judicial decisions – in this Court and in the courts of appeals – that have interpreted Section 318.

1. The language of Section 318 ousts FERC of jurisdiction only where there is an actual conflict between a FERC and an SEC ruling. See Pet. App. 18a-20a. The rule of SEC precedence embodied in Section 318 takes effect only when an entity is subject to "a *requirement* of [PUHCA] and a *requirement* of [the FPA]" with respect to the same subject matter (emphasis added). Further, Section 318, as promulgated by Congress (Public Utility

Act of 1935, ch. 687, Tit. II, § 213, 49 Stat. 863), was entitled "Conflict of jurisdiction." The use of the term "conflict" indicates that Congress intended the provision to take effect only where there is a conflict between actions of the two agencies, not merely where both have authority to regulate the same entity or transaction.

In PUHCA, Congress enacted two provisions that, like Section 318 of the FPA, allocate jurisdiction between the two agencies. Section 21 of PUHCA, 15 U.S.C. 79u, provides that nothing in the statute "shall affect the jurisdiction of any other commission * * * of the United States or of any State * * * insofar as such jurisdiction does not *conflict* with any provision of [PUHCA] or any rule, regulation, or order thereunder" (emphasis added). In enacting this provision, Congress recognized that the public utility industry was subject to regulation by state and federal agencies other than the SEC. The terms of the provision make clear that Congress intended by adopting a rule of "conflict" pre-emption to permit such concurrent regulation.

This conclusion is buttressed by Section 20(b) of PUHCA, 15 U.S.C. 79t(b), which provides that "the rules and regulations or orders of the [SEC] in respect of accounts shall not be inconsistent with the requirements imposed by [any law of the United States] or any rule or regulation thereunder." This provision, like Section 21, shows Congress's recognition that affiliates of public utility holding companies are subject to regulation under other "law[s] of the United States," such as the FPA. In establishing a rule that prohibits the SEC from adopting requirements inconsistent with those of other regulatory agencies, Congress again demonstrated that it did not intend SEC regulation unnecessarily to confine the regulatory authority of other agencies.

In addition to their use of the terms "conflict" or "inconsistent" to trigger their respective rules, Sections 21 and 20(b) of PUHCA undercut the theory on which the court of appeals' field preemption holding is based. The field pre-emption theory adopted by the court of appeals is appropriate in cases in which Congress intended a comprehensive federal regulatory system to "occupy a given field to the exclusion of state law." *Schneidewind* v. *ANR Pipeline Co.*, 108 S. Ct. 1145, 1150 (1988). These provisions, however, make clear that SEC regulation was not intended to be so comprehensive as to leave no room for concurrent, consistent regulation by a sister agency.[12] Cf. *Northwest Central Pipeline Corp.* v. *State Corp. Comm'n*, 109 S. Ct. 1262, 1273-1278 (1989) (co-existence of consistent federal and state regulatory regimes where no congressional intent to occupy the field can be shown).

2. The legislative history of the Public Utility Act of 1935 supports the conclusion that a "conflict" in regulatory "requirements" must be shown before the rule of SEC precedence takes effect. Thus the Conference Report on the Public Utility Act repeatedly stated that

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[12] Thus, contrary to the court of appeals' suggestion (Pet. App. 16a-18a), this Court's decisions in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Mississippi*, 487 U.S. 354 (1988), that FERC's wholesale rate jurisdiction is exclusive were not based on concerns that "cost trapping" would result from permitting concurrent state ratemaking review. Rather, those decisions rested on an interpretation of the FPA as having occupied the field with respect to interstate power rates, and an application of the filed rate doctrine, which holds that such rates "filed with FERC or fixed by FERC must be given binding effect [by states]." *Nantahala*, 476 U.S. at 962-963; accord *Mississippi Power*, 487 U.S. at 371-373.

Section 318 resolved "conflicts" that might arise in concurrent regulation under the FPA and PUHCA. The report stated:

> In subsection (a) of section 318, in which *conflicts* of jurisdiction between the Securities and Exchange Commission and the Federal Power Commission under this bill are resolved in favor of the former, the House amendment adds to such *matters of conflict* the assumption of obligation or liability in respect of a security. The conference substitute is enlarged to include any *conflict* arising under this bill.

H.R. Rep. No. 1903, 74th Cong., 1st Sess. 75 (1935) (emphasis added).

In fact, Congress's concern with including a provision to resolve conflicts between the agencies is traceable through a consistent line of earlier versions of Section 318. Thus, Section 335 of the original House bill introduced on February 6, 1935 (H.R. 5423, 74th Cong., 1st Sess.), was substantially the same as present Section 318, and was entitled "conflict of jurisdiction". Section 316 of the earliest version of the Senate bill (S. 2796, 74th Cong., 1st Sess.), as introduced and referred to the Committee on Interstate Commerce on May 7, 1935, was also entitled "conflict of jurisdiction," and applied "in case of conflict between provisions of the [FPA] and PUHCA." See S. Rep. No. 621, 74th Cong. 1st Sess. 54 (1935).[13]

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[13] In subsequent versions of S. 2796, *supra* (as introduced in the House on June 13, 1935 and as reported from the Committee on Interstate and Foreign Commerce on June 24, 1935), the provision became Section 318 and the "conflict of jurisdiction" title was retained. The House report accompanying it specified that it was designed to govern "conflicts between the two agencies." H.R. Rep. No. 1318, 74th Cong., 1st Sess. 19 (1935).

In June 1935, when the Public Utility Act was under consideration in the House of Representatives, Representative Wadsworth offered an amendment to substitute the FPC for the SEC as the agency responsible for administering Title I of the Public Utility Act, *i.e.*, PUHCA, out of concern for the duplication of effort that the bill could impose on regulated entities seeking to comply with the requirements of both agencies. However, after examining Section 318, he withdrew his proposed amendment and indicated his view that the proper balance between excessive duplication of effort and necessary regulation would be met by Section 318:

> I find, however, * * * that at the very end of the bill * * * in section 318, provision is made for the avoidance of *conflicts in jurisdiction*, and in reading that section I have reached the conclusion that *a large measure* of duplication and overlapping can be, and will be, avoided.

79 Cong. Rec. 10,507 (1935) (emphasis added).

Therefore, although Section 318 in the final bill assured that "a large measure" of duplication would be avoided by giving precedence to SEC regulations in cases of "conflict," there is no evidence that Congress intended entirely to oust FERC from the field simply because PUHCA imposes a not inconsistent requirement on the regulated entity. Pet. App. 14a. The statute's use of the term "requirement," together with the reference to "conflicts" in the title of Section 318 and (repeatedly) in its legislative history, and Congress's express recognition in several provisions that other agencies have concurrent jurisdiction over public utilities, lead to the conclusion that only in cases of conflicting requirements imposed under the two statutes does Section 318 override FERC's jurisdiction.

3. Judicial interpretation of Section 318 has been based on the proposition that an actual conflict between requirements imposed by each agency is a prerequisite to applying Section 318's rule of SEC precedence. Thus, in *Northwestern Electric Co.* v. *FPC*, 321 U.S. 119 (1944), an operating electric utility subsidiary of a registered holding company argued, *inter alia*, that a particular accounting treatment required by the FPC under the FPA was in conflict with the accounting regulations of the SEC. See pp. 14-16, *supra*. This Court rejected the claim that PUHCA-based accounting requirements absolved the utility of any obligation to comply with consistent FERC-based regulation in the following passage:

> The petitioners attack the regulations as in conflict with the *powers and the regulations* of the Securities and Exchange Commission, *which also has regulatory power* over Northwestern; but an examination of the statute and of the orders and proceedings of the Securities and Exchange Commission satisfies us that *no conflict exists*.

321 U.S. at 125 (emphasis added). The "no conflict" rule upon which the Court relied—which was fully in accord with the SEC's submission to the Court—is precisely the approach advocated by the SEC and FERC in this case.

In a subsequent case, the Fourth Circuit, expressly relying on *Northwestern Electric*, followed the same approach in resolving an operating utility's claim that an FPC-imposed accounting requirement was preempted under Section 318 by allegedly inconsistent accounting regulations imposed by the SEC. In *Appalachian Power Co.* v. *FPC*, 328 F.2d 237 (4th Cir.), cert. denied, 379 U.S. 829 (1964), the Fourth Circuit held that "[u]nder section 318 of the Federal Power Act * * * *actual conflicts* between the FPC and the SEC are resolved in favor of the SEC."

328 F.2d at 250 (emphasis added). After a careful analysis of the accounting rules at issue in the case, the court concluded that "the effort to discover an *incompatibility* between the two governmental agencies must fail," *id.* at 252 (emphasis added), and that Section 318 was therefore not triggered.[14] This reasonable construction of Section 318 would be foreclosed under the broad field pre-emption rule adopted by the panel majority below.

C. Interpreting Section 318 To Apply Only In Cases Of Actual Conflict Is Appropriate In Light Of The Substantially Different Goals And Capabilities Of The SEC And FERC

Congress's decision to entrust administration of PUHCA to the SEC and administration of the FPA to FERC was based on its pursuit of two differing goals in regulating utility subsidiaries of holding companies. In light of this intended difference between the two regulatory regimes, the congressional purpose can be achieved only if each agency is allotted the opportunity to pursue its own regulatory mission, *i.e.*, if the concurrent, consistent regulations of both agencies are held to be

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[14] In *Mississippi Industries* v. *FERC*, 808 F.2d 1525, 1550-1551, reh'g granted and vacated in part on other grounds, 822 F.2d 1104 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987), the D.C. Circuit discussed the applicability of Section 318 to an agreement involving the wholesale sale of electricity among holding company subsidiaries. Relying on the SEC's explanation that PUHCA excluded inter-affiliate sales of electricity from SEC jurisdiction (808 F.2d at 1550), the court held that Section 318 did not oust FERC of jurisdiction. Like this Court in *Northwestern* and the Fourth Circuit in *Appalachian Power*, the D.C. Circuit reached this holding by finding that there was no "inconsistency" between the actions taken by the two agencies (*ibid.*), and that there was no "conflict" between FERC and the SEC (*id.* at 1551). The D.C. Circuit panel in this case did not discuss its understanding of this language from *Mississippi Industries*. See Pet. App. 13a.

valid in the absence of actual conflict. The court of appeals erred because it largely failed to appreciate the differing goals underlying each statute, and therefore discounted the need to give each agency latitude to administer its own statute.

1. a. PUHCA was designed to eliminate the notorious financial abuses documented in the Federal Trade Commission report and other studies. See note 2, *supra*. Among the specific abuses Congress found to trigger the need for stringent regulation were abuses in the issuance of securities such as "the absence of uniform standard accounts" for investor information, the issuance of securities based upon "fictitious or unsound asset values," and the "overcapitalized" holding company structures that tended to "prevent voluntary rate reductions." 15 U.S.C. 79a(b)(1). Also underlying the stringent regulatory regime instituted by PUHCA were the "excessive charges" that operating subsidiaries had to pay to service and supply affiliates resulting from "an absence of arm's-length bargaining" (15 U.S.C. 79a(b)(2)), and the allocation of costs among holding company subsidiaries to thwart effective state regulation (15 U.S.C. 79a(b)(2) and (3)).

To eliminate these primarily financial abuses, PUHCA is directed largely toward financial transactions, corporate structures, acquisitions of assets, and potential conflicts of interest. See generally *Public Utility Holding Company Act: Hearings on H.R. 5220, H.R. 5465, and H.R. 6134 Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 97th Cong., 2d Sess. 553, 579-583 (1982) (statement of SEC concerning proposals to amend or repeal the Public Utility Holding Company Act of 1935). Congress therefore entrusted the administration of PUHCA to the SEC, the agency with expertise in financial transactions and corporate finance.

b. Although also enacted as part of the Public Utility Act of 1935, the FPA resulted from an entirely different problem—the regulatory gap created by *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927), in which the Court held that interstate wholesale sales of electricity were beyond the reach of state regulation. The FPA was thus directed primarily at operational and ratemaking issues in particular, rather than issues of corporate structure and securities regulation. Congress therefore entrusted administration of the FPA to the FPC, the agency most qualified to deal with the engineering and energy policy issues that arise in the course of regulating energy generation and transmission. In short, the Public Utility Act of 1935 was divided into separate sections conferring distinct responsibilities on two separate agencies, even though affected companies would be subject to the overlapping regulatory authority of the two agencies.

c. Although the underlying purposes of the two regulatory schemes were different, the possibility of conflicts between the agencies remained. Throughout PUHCA, the SEC is repeatedly authorized to take regulatory action with respect to holding companies "in the public interest or for the protection of investors or consumers." *E.g.*, 15 U.S.C. 79e(a), 79f(b), 79g(a), 79j(a), 79k(b)(1), 79m(b), 79*o*(b). The FPA in turn gives FERC regulatory authority to act "in the public interest," *e.g.*, 16 U.S.C. 824a(a), 824b(a), and to set rates that are "just and reasonable," *e.g.*, 16 U.S.C. 824d(a), 824e(a). The content of "the public interest" under PUHCA and the determination of what PUHCA requires "for the protection of investors or consumers" is largely within the discretion of the SEC; similarly, FERC has broad authority to determine the scope of the similar terms of the FPA. Because the SEC may determine that PUHCA requires actions that are in conflict with actions that FERC determines are

necessary under the FPA, a rule for resolving conflicts was necessary.

The fact that the statutory "public interest" standards under which the SEC and FERC operate are verbally similar does not alter the conclusion that regulation by each agency was intended in general to achieve different purposes, consider different factors, and take advantage of distinct spheres of expertise. The differing focus of the SEC and FERC is illustrated by *City of Lafayette* v. *SEC*, 454 F.2d 941 (D.C. Cir. 1971), aff'd *sub nom. Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 754-755 (1973). *City of Lafayette* involved orders by the SEC and the FPC approving issuances of securities by two utilities, one of which was a holding company subsidiary subject to PUHCA, the other of which came only within the jurisdiction of the FPA. Both orders were attacked on the same ground—that the funds raised would be used to finance a conspiracy between the two utilities to suppress competition. The court recognized that both the SEC and the FPC operated under a broad "public interest" charter. 454 F.2d at 948. Nonetheless, the court held that the FPC, because of its broad mandate "to enhance optimum interconnection and interchange of electric energy, not to mention its array of other activities in furtherance of electric energy capability," *id.* at 951, had to take the complaint into account before approving the financing, while the SEC, which had "no regulatory authority over operations of the utility," *ibid.*, could reasonably refuse to do so. In short, despite the fact that both agencies had what appeared to be the identical task of regulating in the "public interest," the court found that the purposes toward which the regulation was aimed were substantially different.[15]

[15] The SEC has repeatedly emphasized that its function is distinct from that of FERC, most notably in statements disclaiming authority

The basis of the decision in *City of Lafayette*—that the FPC and the SEC were required to regulate similarly situated entities with substantially different ends in view—underscores that the proper interpretation of Section 318 permits consistent, concurrent regulation by the two agencies. Because regulation by the SEC may not be an adequate substitute for regulation by FERC, ousting FERC of jurisdiction in the absence of an actual conflict with SEC regulation would threaten to frustrate achievment of Congress's regulatory objectives. Given the differing regulatory missions of the two agencies, the actual conflicts standard best preserves the ability of each agency to meet the congressional goals of regulation under its respective statute.

2. There are a number of specific areas of regulatory overlap in which application of the broad field preemption analysis embraced by the majority below would

over ratemaking. As the SEC explained in *The Southern Co.*, HCAR No. 21665, 20 SEC Dkt. 799, 801 (Aug. 5, 1980):

> The Federal Power Act, adopted as Title II of the statute of which the Holding Company Act was Title I, separated those matters of Federal concern which involved rates and operations, and assigned their administration to another agency, now the [FERC], specially qualified and equipped to deal with the technology of energy generation and tr nsmission.

See also *American Elec. Power Co.*, 46 S.E.C. 1299, 1323 (1978) ("[O]ur control over [holding companies] relates only to their structure, to their intra-system transactions, and to their finances. We have no power over their dealings with their customers, retail or wholesale." (citing *City of Lafayette*)); *accord Louisiana Power & Light Co.*, HCAR No. 22765, 26 SEC Dkt. 1422, 1431 (Dec. 21, 1982); *New England Elec. Sys.*, HCAR No. 22309, 24 SEC Dkt. 298, 308 (Dec. 1, 1981); *Arkansas Power & Light Co.*, 45 S.E.C. 567, 574 (1974); *Vermont Yankee Nuclear Power Corp.*, 43 S.E.C. 693, 699 (1968); *New England Power Serv. Co.*, 10 S.E.C. 562, 571 (1941).

threaten to disrupt long-standing cooperation between the two agencies to achieve their regulatory goals. Among the most important of these is the transfer of securities and utility assets. Sections 9 and 10 of PUHCA, 15 U.S.C. 79i, 79j, generally prohibit holding companies and their affiliates from acquiring securities or utility assets without SEC approval. However, Section 203 of the FPA, 16 U.S.C. 824b, provides that FERC approval is required before any public utility may "sell, lease, or otherwise dispose of" its facilities or "merge or consolidate such facilities * * * with those of any other person." Thus, as a general matter, while PUHCA gives the SEC jurisdiction over *acquisitions* of securities and utility assets by holding company affiliates, the FPA gives FERC jurisdiction over the *sales* of the same items by public utilities. In any transaction in which a holding company affiliate purchases securities or utility assets of a public utility, both the SEC and FERC will have regulatory authority over the transaction.[16]

If the field pre-emption approach to Section 318 adopted by the court below were accepted, FERC's concurrent authority over such transactions—even in cases in which the exercise of that authority in no way conflicts with SEC regulation—would be called into question. In the words of the majority below, Sections 9 and 10 of PUHCA could be taken to establish that "it is for the SEC rather than FERC to determine" whether the transfer in

[16] The view that FERC may regulate some aspects of a transaction while the SEC regulates other aspects dates back at least to *In re George B. Evans*, 1 F.P.C. 511, 515-516 (1937), in which the FPC exercised jurisdiction over the "sale and lease" of electrical facilities under Section 203 of the FPA, while the SEC had earlier exercised its jurisdiction over the purchase of facilities, as well as the issuance of securities, in connection with the same transaction. See pp. 18-19, *supra*. See also *In re Olcott Falls Co.*, 3 F.P.C. 310, 312 (1942).

question was appropriate. See Pet. App. 14a. Thus, the SEC would become the sole entitity with regulatory jurisdiction over the "subject matter" of such transactions, despite the fact that the goals of SEC regulation under Sections 9 and 10 of PUHCA [17] differ dramatically from the goals of FERC regulation under the FPA.[18] A regulatory gap would be opened, and important aspects of the transaction would, contrary to congressional intent, go unregulated.[19]

[17] Among the goals of SEC regulation under Sections 9 and 10 are the avoidance of undue concentration of control over utilities (see 15 U.S.C. 79j(b)(1)), preclusion of corporate waste in transaction fees (see 15 U.S.C. 79j(b)(2)), and avoidance of unduly complicated capital structure (see 15 U.S.C. 79j(b)(3)).

[18] FERC has stated that its goals under Section 203 of the FPA include ensuring "maintenance of adequate service and coordination of facilities in the public interest," see *Savannah Elec. & Power Co.*, 42 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,240, at 61,778 (1988). See also *Central Illinois Public Serv. Co.*, 42 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,073 (1988). The *Savannah Electric* case involved the sale of utility assets to a public utility holding company. The utility argued to FERC that, because the SEC had already approved the purchase of the utility assets under PUHCA, see *The Southern Co.*, HCAR No. 24579, 40 SEC Dkt. 442 (Mar. 1, 1988), Section 318 ousted FERC from any further jurisdiction over the matter. Noting that "section 318 comes into play only when there is a direct conflict between this agency and the SEC," and that "no conflict has been demonstrated between our responsibility to protect the interests of ratepayers and to ensure reliable and adequate service and the SEC's mandate under PUHCA," FERC held that it could "fulfill [its] obligations under section 203 of the FPA in a manner that is complementary to the SEC's jurisdiction over reorganization transactions." 42 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,073, at 61,328.

[19] Even under the actual conflict approach, FERC action in passing upon the transfer of utility assets could pose a conflict with SEC action with respect to the same transaction. However, unlike the field pre-emption approach adopted by the court of appeals, analyzing the situation in terms of whether it poses an actual conflict would leave

Nor is the overlap between SEC and FERC authority limited to Sections 9 and 10 of PUHCA and Section 203 of the FPA. With respect to accounting rules, Sections 15(a) and 20(a) of PUHCA, 15 U.S.C. 79*o*(a), 79t(a), grant the SEC broad authority to prescribe uniform systems of accounting for holding companies and their affiliates. Similarly, Section 301 of the FPA, 15 U.S.C. 825, grants broad authority to FERC to prescribe methods of accounting to be used by public utilities.[20] The SEC's designation of accounting methods to be used for its reporting purposes and for purposes of disclosure to investors is obviously not inconsistent with FERC's designation of accounting methods to be used in ratemaking proceedings.[21] Yet a broad field preemption analysis in this

substantial latitude for FERC to impose conditions on the transaction in accord with its mandate under the FPA. Cf. *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 759 (1973) (FPC has broad powers under the FPA to impose conditions on transaction before approving it).

[20] As FERC has emphasized in a recent case, "[i]t is essential that [FERC] have available to it for ratemaking purposes a set of financial statements that will enable it to determine the current cost of providing service under its adopted scheme of regulation and to be able to properly monitor past performance under approved rates by inspection of financial statements that comport with the ratemaking principles used to develop them." *Arkansas Power & Light Co.*, 41 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,034, at 61,084 (1987).

[21] The concurrent regulation of accounting matters by both agencies is illustrated by *In re Oklahoma Gas and Electric Co.*, 22 S.E.C. 209, 219 (1946), in which the SEC noted that its approval of the accounting treatment of a particular transaction is "not intended to restrict or otherwise affect the jurisdiction of the Federal Power Commission." The FPC subsequently modified the treatment of the same transaction, *In re Oklahoma Gas and Electric Co.*, 5 F.P.C. 52, 54, 59 (1946), and the SEC accordingly modified its own order to avoid inconsistency. *In re Oklahoma Gas and Electric Co.*, 22 S.E.C. 466 (1946).

area could threaten to undermine the ability of FERC to obtain the information it requires to fulfill its statutory mandate under the FPA when, under certain circumstances, the "subject matter" of accounting is also regulated by the SEC.[22]

3. The court of appeals misinterpreted Section 318 because it failed to appreciate the difference in goals and expertise between the two agencies.[23] Under a more appropriate analysis, the court of appeals would not have simply determined that PUHCA gives the SEC authority over inter-affiliate contracts for the sale of goods and then concluded that FERC therefore can have no regulatory role with respect to those same arrangements. Instead, the

[22] Although Section 20(b) of PUHCA, 15 U.S.C. 79t(b), requires that SEC accounting rules "not be inconsistent" with the "requirements imposed by [any law of the United States] or any rule or regulation thereunder," SEC accounting rules could differ from those of FERC in ways that are not "inconsistent" with those rules, but that nonetheless require somewhat less or different information from a regulated entity. In such a case, application of a broad field preemption theory could impair FERC's ability to obtain the information it needs for ratemaking purposes.

[23] Thus, in a portion of its opinion (Pet. App. 9a-13a) in which it rejected the argument that Section 318 is inapplicable to this case because FERC and the SEC regulate different "subject matter," the court noted the similarity of regulatory mission between the SEC and FERC. In general, it should be possible to resolve issues arising under Section 318 without attempting to define precisely whether the "subject matter" as to which the SEC has imposed "requirements" is the same as the "subject matter" as to which FERC has imposed "requirements." Under the actual conflict analysis that we propose, the key issue is the pragmatic determination of whether the regulatory requirements are in conflict. If they are, Section 318 gives precedence to the SEC requirement. If they are not, they are unaffected by Section 318.

court should have inquired whether there is any conflict between actual SEC and FERC regulation. Only if requiring Ohio Power to comply with FERC's order in this case would conflict with that company's obligation to comply with the four SEC orders would Section 318 render the FERC order invalid. The court of appeals expressly refused to undertake this inquiry, which depends on the meaning of four SEC orders that have never been construed by any court and that relate to a particular coal mining operation of no general legal significance. This Court should remand the case to the court of appeals so that the necessary inquiry into the meaning of the four SEC orders can be undertaken.

CONCLUSION

For the foregoing reasons, the decision below should be reversed, and the case remanded to the court of appeals for further proceedings.

Respectfully submitted.

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MAY 1990

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* The Solicitor General is disqualified in this case.

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No. 89-1283

In the Supreme Court of the United States

OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,

Petitioners,

v.

OHIO POWER COMPANY, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Brief for Registered Holding Company Group as *Amici Curiae* in Support of Ohio Power Company

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Question Presented for Review

Whether section 318 of the Federal Power Act, 16 U.S.C. § 825q, prohibits the Federal Energy Regulatory Commission from limiting a utility to recovery of a "comparable market" price for coal purchased from an affiliated company when the Securities Exchange Commission subjects the transaction to an "at cost" standard pursuant to the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79a *et seq.*

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In the

Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1283

ARCADIA, OHIO, *et al.*,

Petitioners,

v.

OHIO POWER COMPANY, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Brief for Registered Holding Company Group as *Amici Curiae* in Support of Ohio Power Company

Interest of *Amici Curiae*

This brief is submitted on behalf of a group[1] (the Registered Holding Company Group) that consists of six holding companies that are registered with, and subject to certain regulation by, the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (HCA). At the end of 1988, and for the year then ended, the aggregate consolidated assets and annual revenues of the members of the Group were, respectively, $55 billion and $18 billion.

[1] The members of the Group are Central and South West Corporation, Eastern Utility Associates, Entergy Corporation, General Public Utilities Corporation, New England Electric System and The Southern Company. The Group has obtained the consent of all parties to the case to the filing of this brief and the letters of such parties granting such consents have been lodged with the Clerk of the Court.

The result of Opinions and Orders Nos. 272 and 272-A[2] of the Federal Energy Regulatory Commission (FERC) relating to Ohio Power Company (OPCO), a public utility subsidiary of another registered holding company (American Electric Power Company), would be to subject OPCO (and the subsidiaries of other registered holding companies, such as the members of the Group) to duplicative and, as in this case, irreconcilable regulatory requirements under the HCA and the Federal Power Act (FPA). In its decision here under review, *Ohio Power Company v. Federal Energy Regulatory Commission*, 880 F.2d 1400 (D.C. Cir. 1989), the Court of Appeals vacated the FERC's order.

The Registered Holding Company Group unqualifiedly supports the decision of the Court of Appeals and herein primarily addresses the brief for the FERC and SEC (collectively the Federal Respondents).

Summary of Argument

The HCA and FPA were enacted in 1935 in a single statute, the Public Utility Act of 1935. They resulted from two bills, separately and independently drafted which had been intended to be introduced as separate pieces of legislation. It was recognized that, by reason of this history, there were some conflicts of jurisdiction between the SEC and FERC and Section 318 was included in the FPA for the express purpose of resolving such conflicts of jurisdiction in favor of the HCA.

By its express terms, FPA Section 318 denies jurisdiction to the FERC to impose any requirement with respect to the pricing of coal sold to Ohio Power Company (OPCO) by its affiliate, Southern Ohio Coal Company (SOCCO), since HCA Section 13(b) requires that such sale be made at cost.

In general, FPA Section 318 provides that if the SEC has any jurisdiction over any subject matter by reason of the self-

[2] *Ohio Power Company*, 39 Fed Energy Reg. Comm'n (CCH) ¶61,098 (1987) and 43 Fed. Energy Reg. Comm'n (CCH) ¶61,046 (1988) (herein collectively referred to as "Opinion No. 272."

operative provisions of the HCA or the implementation of the HCA by a rule, regulation or order thereunder, there is no concurrent or dual jurisdiction in FERC unless specifically mandated by the HCA or rules, regulations or orders thereunder. HCA Section 20(b) provides an express exception to that general rule by directing that the rules adopted by the SEC in respect of accounts shall not be inconsistent with those adopted by the FERC under the FPA. But this merely demonstrates that when Congress wanted to provide in the HCA and FPA for dual or concurrent regulation, it did so explicitly.

This view of the interrelationship of the two parts of the single statute is reinforced by the overall legislative history of the statute and by the specific legislative history of FPA Section 318. Indeed, in commenting on Section 318 in 1935 in an analysis furnished by the SEC to the Conference Committee, the SEC characterized the effect of Section 318 as being that "companies will be subject to regulation in respect of the same subject matter by only one commission at a time."

Thus, even if there were no actual conflict between (a) the "at-cost" directive of HCA Section 13(b) for the pricing of coal sold by SOCCO to OPCO and (b) the "market price" directive of the FERC in opinion No. 272, FPA Section 318 would deny jurisdiction to the FERC to adopt Opinion No. 272.

The FERC position stated in Opinion No. 272 was that FPA Section 318 was not applicable because the subject matter before the FERC was not the same as the subject matter before the SEC. However, in the brief on the merits of the Federal Respondents, that argument is essentially abandoned. (Federal Respondents' brief at 25, note 23). Essentially, they shift to arguing (at 36) that this Court should remand to the Court of Appeals to examine the four SEC orders. They then state that:

> "only if requiring [OPCO] to comply with FERC's order in this case would conflict with [OPCO's] obligation to comply with the four SEC orders would Section 318 render the FERC order invalid."

That position, however, overlooks the fact that, as stated by the Court of Appeals (at 1409), its decision rested on the threshold

matter of the language of the statute and not on the four SEC orders.

The decision of this Court in *Northwestern Electric* and of the Fourth Circuit in *Appalachian Power* do not support the position of the Federal Respondents in this case. Both *Northwestern* and *Appalachian* involved accounting matters, a subject with respect to which, by reason of HCA Section 20(b), the jurisdiction of FERC is not preempted by the SEC. But, to the extent that those decisions are relevant, they support the position of OPCO and these *amici curiae*.

The early decisions of the FPC in *Evans* and *Olcott Falls* do not support the position of the Federal Respondents in this case. In both cases, the FPC held that, if the SEC had jurisdiction under the HCA, then the FPC did not have jurisdiction under the FPA.

Similarly, the 1948 decision of the SEC in *Appalachian*, 27 SEC 1029, does not stand for the proposition for which it is cited by the Federal Respondents. The portion of that decision that dealt with the pricing of coal sales by Central Coal—as distinguished from the operation of two generating units by a wholly different company, Central Operating—did not assume that the FPC would have jurisdiction. Indeed, for at least two years before, and 39 years after, *Appalachian*, the FERC did not disturb coal sales to OPCO from affiliates priced at cost.

While the 1988 decisions of the FERC in *Savannah* and *Central Illinois* are consistent with the 1987 Opinion No. 272, they can scarcely be accorded precedential support for Opinion No. 272 in light of their sequence.

Opinion No. 272 is not entitled to deference under *Chevron* both because it fails the first test under *Chevron*, namely, that that court must give effect to the unambiguously expressed intent of Congress and because a court cannot affirm an agency decision on a ground other than that articulated by the agency.

I. The Petitioners and Federal Respondents Seek to Confer Upon the FERC Jurisdiction in this Case that is Expressly Denied to the FERC.

A. The Relevant Statutory Provisions Deny Such Jurisdiction to the FERC

The briefs of the Petitioners and Federal Respondents seek to rewrite the provisions of both Section 318 of the FPA and Section 13(b) of the HCA. The analysis in their briefs starts from the assumption that both the SEC and the FERC have jurisdiction. Those briefs then proceed to an analysis of whether there is a conflict between the requirements *imposed by the FERC* and those *imposed by the SEC*. However, the correct starting point is whether the *statutory* provisions themselves completely deny to the FERC any jurisdiction to impose any requirements with respect to the particular subject matter.

Section 318 of the FPA provides in pertinent part that, if with respect to any subject matter, "any person is subject both to a requirement *of the [HCA]*—*i.e.*, of the statute, not of the SEC —or of a rule, regulation or order thereunder and to a requirement *of the [FPA]*—*i.e.*, of the statute, not of the FERC— . . . the requirement *of the [HCA]* shall apply to such person, and such person shall not be subject to the requirement of [*the FPA*] . . . with respect to the same subject matter . . ." . (emphasis supplied)

Thus, contrary to the assumption of the Petitioners and the Federal Respondents, FPA Section 318 does not provide a guide for attempting to reconcile allegedly consistent and concurrent regulatory actions by the SEC and the FERC in the circumstances here presented. Rather, FPA Section 318 denies any jurisdiction to the FERC to impose *any* requirement relating to the pricing of inter-affiliate coal sales between subsidiaries of a registered holding company—whether consistent with, or different from, the standard of Section 13(b) of the HCA.

HCA Section 13(b) imposes by its express terms a requirement *of the HCA* applicable to the subject transactions, namely, it prohibits sales of services or goods between affiliates of a

registered holding company unless such sales are consistent with SEC rules, regulations or orders which, among other things, insure that such contracts are priced "at cost, fairly and equitably allocated." To that end, Section 13(b) provides in relevant part that

> " . . . it shall be unlawful for any subsidiary company of any registered holding company . . . to . . . take any step in the performance of any . . . contract by which such company undertakes to perform services . . . for, or sell goods to, any associate company thereof except in accordance with such terms and conditions and subject to such limitations and prohibitions as the [SEC] by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers *and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies.*" [3] (emphasis supplied)

By the title of Section 318 - "Conflict of Jurisdiction" - , as well as by its express terms, Section 318 of the FPA is addressed to the subject of *jurisdiction*, and denies jurisdiction to the FERC if the SEC has *jurisdiction* under the HCA.

The Federal Respondents' brief asserts (at 22) that HCA Section 21, like FPA Section 318, allocates jurisdiction between SEC and FERC by permitting concurrent regulation unless there is an actual conflict between actions of the two

[3] Section 13(b) authorizes the SEC to exempt from the foregoing provisions transactions which (1) are with an associate company that, among other things, is not a public utility operating within the United States, or (2) involve special or unusual circumstances or are not in the ordinary course of business. The SEC order, dated December 9, 1981, in *New England Electric System*, 24 SEC Docket 229, cited in FERC Opinion No. 272 (at page 61,277) as a basis for FERC's argument that HCA Section 13(b) did not preclude pricing above cost was in fact an exemption order granted by the SEC based on the special or unusual circumstances there presented. No claim has been made that the SOCCO sales to OPCO here involved have been similarly exempted by the SEC from the at cost requirement of Section 13(b).

agencies. This analysis would make FPA Section 318 a nullity. For, if, as the Federal Respondents assert, actual conflicts of actions by the two agencies are required in order to make Section 318 operative, there would have been no need for FPA Section 318—HCA Section 21 would have done all that was required. But, FPA Section 318 was intended to do, and does, much more; it assures, as the SEC stated in its comments to the Conference Committee considering the 1935 Act that "companies will be subject to regulation in respect of the same subject matter by only one commission at a time."

Thus, even if there were no actual conflict between (1) the "at cost" directive of HCA Section 13(b) and the SEC's regulations and orders thereunder and (2) the FERC's "market price" directive in Opinion No. 272, the FERC would nevertheless have no jurisdiction, by reason of the express provisions of FPA Section 318, to prescribe market pricing for SOCCO's sales of coal to OPCO.

As discussed below, HCA Section 20(b) does provide (in respect of accounts) an express exception to the general denial by FPA Section 318 of concurrent jurisdiction to both the SEC and the FERC in respect of any matter. But the general rule directed by Section 318 is that, if the SEC has jurisdiction over any subject matter by reason of the HCA, there is no concurrent or dual jurisdiction in the FERC unless specifically mandated by the HCA or rules, regulations or orders thereunder, *i.e.*, unless otherwise expressly provided in the HCA, once a person is subject to a requirement of the HCA (by reason of the self-operative terms of the particular provision of the HCA or a rule, regulation or order adopted by the SEC thereunder) with respect to *any subject matter*, the FERC lacks jurisdiction to impose *any* requirement relating to that particular subject matter whether it is exactly the *same* requirement as that imposed by the SEC, or is the same requirement plus an additional condition, or is a different requirement, unless the SEC has exempted such person from such requirement of the HCA.

In this case, the Court does not need to determine the full reach of Section 318. For it is abundantly clear that there is

an actual conflict resulting from the FERC's attempt in Opinion No. 272 to impose a market price test (whether market price is above or below cost) for such sales with the at-cost price directive of HCA Section 13(b).

It is undisputed in this proceeding that the coal produced by Southern Ohio Coal Company (SOCCO) and sold by SOCCO to OPCO was priced at SOCCO's cost, as determined in accordance with HCA 13(b). Yet, notwithstanding FPA Section 318, the FERC asserted in Opinion No. 272:

> "*We have taken full account of the fact that the SEC has jurisdiction, under PUHCA, to regulate the price of coal purchased by Ohio Power from the Martinka mine.* The SEC's jurisdiction, however, does not extend to setting rates and determining what fuel costs Ohio Power may collect from its wholesale customers. There is thus no conflict in the regulation by the SEC and the regulation by this Commission[4]." (emphasis supplied)

The FERC was at some pains in Opinion No. 272 to make clear its controlling rationale that:

> "Although the SEC may limit the affiliate transfer price to costs even when market prices are higher than costs, for electric rate purposes Ohio Power will have the option to charge its wholesale customers up to the market price for that affiliate coal. Consequently, Ohio Power is not, as it alleges, required to limit its rate recovery of Martinka coal costs to the lower of the two standards."[5]

Opinion Nc. 272 went even further and directed OPCO to modify its fuel adjustment clause to provide for the recovery through the automatic operation of the fuel adjustment clause of an amount up to the market price for all coal purchased from SOCCO, without regard to whether market exceeds cost.[6]

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[4] Opinion No. 272, 39 Fed. Energy Reg. Comm'n (CCH) ¶61,098 (1987) at page 61,277.

[5] *Ibid*, at page 61,287

[6] *Ibid*, at pages 61,288-9.

In a belated effort to avoid the dilemma created by Opinion No. 272, the Federal Respondents' brief concludes (at 36):

> "Only if requiring Ohio Power to comply with FERC's order in this case would conflict with that company's obligation to comply with the four SEC *orders* would Section 318 render the FERC order invalid." (emphasis supplied)

The brief then requests that this Court remand the case for inquiry by the Court of Appeals into the meaning of the four SEC *orders*. But that request ignores the clear holding of the Court of Appeals that its decision was based on the statute and not on such orders. As the Court of Appeals stated (at 1409):

> ". . . our decision nevertheless rests on the threshold matter of the language of the statute, which commits the determination of the inter-associate price to the SEC. Whether the SEC acquits itself well or ill is not our present concern."

B. Contrary to the Claim of the Federal Respondents, Neither the FPA nor the HCA Provides for Concurrent Regulation Except With Respect to Accounting Matters

The Federal Respondents' brief asserts (at 12 and elsewhere) that:

> ". . . the agencies take the position that Section 318, along with several provisions of PUHCA, allow substantial room for concurrent, consistent regulation."

As we have demonstrated, that view is not supported by the terms of FPA Section 318 itself. Moreover, as we shall demonstrate below (at pages 12-17), that view is not supported by the legislative history of the Public Utility Act of 1935 in which, for example, the SEC (in its analysis submitted to the Conference Committee) characterized Section 318 in the following terms:

> "In general, the effect of the provision above quoted will apparently be that companies will be subject to

> regulation in respect of the same subject matter by only one Commission at a time . . . "

Moreover, that view is not supported by the two provisions of the HCA (Sections 21 and 20(b)) which the Federal Respondents' brief cites as providing such support (at 22).

Specifically, HCA Section 21 provides (in pertinent part):

> " . . . nor shall anything in [the HCA] affect the *jurisdiction* of any other commission . . . of the United States . . . over any person . . . or contract insofar as such *jurisdiction* does not conflict with any provision of the [HCA] or any rule, regulation or order thereunder." (emphasis supplied)

The corollary of that provision is that, if the jurisdiction of another commission [e.g. the FERC] does conflict with any provision of the HCA [e.g. Section 13(b) directing "at-cost" pricing of sales between affiliates], such HCA provision controls. Stated in another way, although the provision is stated in a somewhat convoluted form, its meaning as applied to this situation is that, since the SEC has *jurisdiction* and a statutory command under HCA Section 13(b) to prescribe inter-affiliate pricing of coal purchases at cost, any claim by the FERC of *jurisdiction* under the FPA to price such inter-affiliate coal purchases on any basis other than cost conflicts with the HCA and, therefore, such a claim of jurisdiction by the FERC is proscribed by HCA Section 21.

Nor are the Federal Respondents correct in their assertion that their position "is buttressed by" Section 20(b) of the HCA, which provides in pertinent part:

> "(b) In the case of the accounts of any company whose methods of accounting are prescribed under the provision of any law of the United States . . . the rules and regulations or orders of the [SEC] in respect of accounts shall not be inconsistent with the requirements imposed by such laws or any rule or regulation thereunder; . . . But this provision shall not prevent the [SEC] from imposing such additional requirements regarding reports or accounts as it may deem

> necessary or appropriate in the public interest or for the protection of investors or consumers."

What Section 20(b) of the HCA demonstrates, instead, is that when Congress wanted to provide in the HCA and FPA for dual regulation in relation to a specific matter, namely, the keeping of accounts, it did so explicitly. In the absence of HCA Section 20(b), the provisions of HCA Sections 15 and 20(a) giving the SEC authority to prescribe many accounting matters, coupled with Section 318 of the FPA, could have produced a result in which the FERC did not have jurisdiction over accounting matters for subsidiaries of registered holding companies. However, this was an area where Congress concluded in both the FPA and HCA that regulation by both the SEC and the FERC was appropriate and, in HCA Sections 15, 20(a) and 20(b) and in FPA Section 301(b), it made explicit provisions for it.

It is also noteworthy that Congress did not make the FERC accounting regulations under the FPA pre-emptive as against SEC accounting requirements under HCA Sections 15 and 20(a). Instead, HCA Section 20(b) expressly permits the SEC to prescribe "such additional requirements regarding reports or accounts as it may deem necessary or appropriate."

Thus, the pattern and interrelations of the statutory provisions of the HCA and FPA are clear, namely:

1. As a general rule, by virtue of FPA Section 318, if a person would be subject with respect to any matter to a requirement *of the HCA* and to a requirement *of the FPA*, such person is not subject to *the FPA* requirement with respect to that matter and the FERC has no jurisdiction of that matter.
2. By virtue of HCA Section 21, nothing in the HCA affects the jurisdiction of the FERC over any person "insofar as such jurisdiction of the FERC does not conflict with any provision of the HCA, or rule, regulation or order thereunder". However, if such jurisdiction of the FERC does conflict with any provision of the HCA, then the HCA does apply and the FPA does not.

3. There are three qualifications with respect to the foregoing, namely, (a) if the SEC has exempted a person from an HCA requirement, then an FPA requirement applicable to such person is not preempted, (b) if the HCA provision is not self-operative by its terms and has not been implemented by an SEC rule, regulation or order, then the FPA requirement applicable to such person is not preempted until such provision is so implemented by the SEC, and (c) if accounting matters are involved, the SEC requirements shall not be inconsistent with FERC requirements, but the SEC may also impose additional requirements.

C. The Overall Legislative History of the FPA and the HCA Supports the Holding of the Court of Appeals.

The brief of the Federal Respondents (at 3) characterizes the article of Dozier DeVane, *Highlights of Legislative History of the Federal Power Act of 1935 and the Natural Gas Act of 1938*, 14 Geo. Wash. L. Rev. 30, 37 (1945) as "the history of the consolidation of the two statutes into what ultimately became the Public Utility Act of 1935." But the Federal Respondents' brief fails to discuss the relevant portions of that history, as described in that Article.

At the time of the drafting and enactment of the Public Utility Act of 1935, Mr. DeVane was the Solicitor of the Federal Power Commission and he and FPC Commissioner Seavey were the major drafters and proponents before the Congressional Committees of the Titles II and III of that Act.[7] In his 1945 article, he pointed out that Title I of that Act (the HCA) and Titles II and III of that Act (the FPA) resulted from "two bills, separately and independently drafted [which] were intended to be introduced in Congress as separate pieces of legislation."[8] However, early in 1935, it was determined by the Congressional leaders that the two bills should be consolidated and introduced in Congress as a single bill.

[7] For Commissioner Seavey's role in drafting the 1935 amendments to the Federal Power Act, see 3 FPC iii (1942-3). At the time of publication in 1945 of his cited article, Mr. DeVane was United States District Judge of the Northern and Southern Districts of Florida.

[8] *Op. Cit.*, at 37.

Mr. DeVane's article states that, due to the fact that "each bill had been prepared entirely independently of the other," there were some conflicts in the proposed legislation and the task of redrafting them into a single bill turned out to be more of an undertaking than the time allotted for the task permitted. His article then states (footnotes omitted).[9]

> "When it became obvious that the task assigned the committee could not be accomplished in the time allotted, those in charge of the drafting of the two bills got together and agreed upon the substance of an amendment to the Holding Company Bill, later incorporated in Section 3 of that Bill, (which was intended to provide for full cooperation between the Securities and Exchange Commission and the Federal Power Commission in administering the two acts) and to Section 318 of the Federal Power Bill (now Section 317 of that Act), resolving conflicts in favor of the Holding Company Act. The two bills, as originally drafted, but with the addition of Section 318, were then consolidated into a single bill without further change and introduced by Senator Wheeler (S.1725), and Congressman Rayburn (H.R. 5423), on the same day, February 6, 1935, as the 'Public Utility Act of 1935'."

As discussed below, the direct challenge by the FERC to the pre-emptive jurisdiction of the SEC under the HCA by reason of FPA Section 318 is a recent phenomenon.

D. The Specific Legislative History of Section 318 of the FPA Supports the Holding of the Court of Appeals

As stated in Mr. DeVane's article, the substance of the present Section 318 of the Federal Power Act (initially Section 317) was contained in the original version of the 1935 Act proposed in H.R. 5423 introduced by Congressman Rayburn and in S. 1725 by Senator Wheeler. FPC Commissioner Seavey, at the invita-

[9] *Op. Cit.* at 37-38. Nothing in Mr. DeVane's article suggests that FPA Section 318 should be taken at other than face value — *i.e.*, nothing therein supports the position of the Federal Respondents that Section 318 relates only to conflicts in *holdings* by the FERC and SEC rather than in *jurisdiction*.

tion of the House Committee on Interstate and Foreign Commerce, presented a memorandum discussing Titles II and III of H.R. 5423. Insofar as Section 317 of that bill was concerned, that memorandum stated (Hearings before House Interstate and Foreign Commerce Committee on H.R. 5423, at 388):

> "Section 317 provides that in case of conflict between *the provisions* of the Federal Power Act and the Holding Company Act of 1935 the requirements of the latter *act* shall apply." (emphasis supplied)

The May 13, 1935 Report of the Senate Committee on Interstate Commerce (74th Cong., 1st Session, Report No. 621) accompanying S.2796, described (at page 54) what was Section 316 in that bill in the following terms:

> "Section 316 provides that in case of conflict between *the provisions of* the Federal Power Act and the Public Utility Holding Company Act of 1935, the requirements of the latter *act* shall apply, unless the person subject to such requirement has been exempted by the Securities and Exchange Commission." (emphasis supplied)

The June 24, 1935 Report of the House Committee on Interstate and Foreign Commerce (74th Cong., 1st Session, Report No. 1318), accompanying the House substitute for S.2796, described (at page 35) what was Section 318 in that bill in the following terms:

> "This section provides that in case of conflict between the *provisions* of the amended Federal Power Act and the Public Utility Holding Company Act of 1935, the requirements of the latter *act, and not those of the Power Act*, shall apply, unless the person subject to such requirement has been exempted by the Securities and Exchange Commission." (emphasis supplied)

During the debate in the House, a floor amendment of Section 318 was adopted by the House that would have radically changed the thrust of Section 318. Specifically, that floor amendment provided that, with respect to any of the

matters specified in Section 318, in the event that a person would be subject to the law of any state or regulation by a state commission, such person would not be subject to a requirement under the Federal Power Act or rule or regulation thereunder. See 79 Cong. Rec. 10574-5 (1935). However, that amendment did not survive in conference.

While the combined HCA and FPA bill was before the Conference Committee, the SEC submitted an analysis of the material differences between the bill as passed by the Senate and by the House.[10] The SEC comments in general did not discuss the provisions of the Federal Power Act except where they seemed to affect the duties of the SEC. In that context, the SEC Comments stated:

> "Most of the provisions of this title do not directly concern the Securities and Exchange Commission. Part II of this title in general provides for regulation by the Federal Power Commission of persons who own or operate facilities for the transmission of electric energy in interstate commerce or the sale of electric energy at wholesale in interstate commerce. . . . In several respects the regulation authorized by this title is similar to that authorized by the Holding Company Act. Thus Section 203 concerns the disposition of property, consolidations and purchase of securities; Section 204 provides for the regulation of the issuance of securities and assumption of liabilities; and Sections 301 and 302 (304 in the House Bill), respectively, provide for the making of accounts and periodic and other reports.
>
> "There will be many holding companies and their subsidiaries which would be subject to the provisions above referenced to were it not for Section 316 of the Senate Bill and 318 of the House Bill . . .
>
> "In general, the effect of the provision above quoted will apparently be that companies will be

[10] Appendix B to Petition of FERC for Rehearing and Suggestion for Rehearing *En Banc*, dated September 11, 1989, to Court of Appeals.

> subject to regulation in respect of the same subject matter *by only one Commission at a time*, but in case a company ceases to be a holding company or subsidiary it will automatically be immediately transferred from the *jurisdiction* of the Securities and Exchange Commission to that of the Federal Power Commission. For this reason it will be necessary for the two Commissions to collaborate closely in the preparation of regulations." (emphasis supplied)

In describing the conference substitute bill, the Managers on the part of the House (in House Report 1903, 74th Cong. *1st* Session, August 23, 1935) stated in part,

> "In subsection (a) of section 318, in which conflicts *of jurisdiction* between the Securities and Exchange Commission and the Federal Power Commission under this bill are resolved in favor of the former, the House amendment adds to such matters of conflict the assumption of obligation or liability in respect of a security. The conference substitute is enlarged *to include any conflict* arising under this bill. (emphasis supplied)
>
> 'Subsection (b) of section 318, in the House amendment, excluded Federal regulation as provided in the two new parts added to the Power Act, of any matter as to which there is authority in a State commission. This subsection in the Senate bill provided that an interstate public-utility company shall not by this act be relieved from compliance with State laws. The conference substitute omits this subsection."

Thus, from the beginning and throughout the congressional consideration of the 1935 Act, it was clear that (1) the initial drafters of HCA Section 318 (who were principally associated with the FPC) and the Congressional bodies adopting the proposed legislation did not intend that a utility should be subjected to dual or concurrent regulation under the FPA and under the HCA and (2) in the event of a conflict between the two acts (which was likely), jurisdiction would be resolved in favor

of the HCA. As noted above, this intention was underscored by the inclusion in Section 318 of the conference committee substitute bill of the phrase "or any other subject matter."

Against this background, we submit that the Federal Respondents' brief (at 25) misinterprets the explanation by Representative Wadsworth of his reasons for withdrawal of a floor amendment that he had previously offered. Representative Wadsworth stated the objective of his proposed amendment had been to eliminate

> "the very serious and extensive duplication of effort and expense, both to the Government and to the persons to be supervised, if this jurisdiction over the utilities field should be divided between the Securities and Exchange Commission and the Federal Power Commission. It was the purpose of my amendment to center the jurisdiction in one commission in order to avoid such duplication." 79 Cong. Rec.-10507 (1935)

A little later, Representative Wadsworth added:

> " . . . section 318 in large measure meets my objection, and I, therefore, ask unanimous consent to withdraw the amendment which I offered on Saturday afternoon." (*Ibid*)

II. To the Extent Relevant, the Prior Decisions of this and Other Courts and of the two Commissions do Not Sustain the Position of the Petitioners and Federal Respondents

A. *Northwestern Electric Co. v. FPC*, 321 U.S.119 (1944)

Both the Federal Respondents and the Petitioners claim (on three occasions in each of their briefs) that the holding of the Court of Appeals is inconsistent with the decision of this Court in *Northwestern Electric Co. v. FPC*, 321 U.S. 119 (1944). However, in the light of the vigor of the presentations of the Federal Respondents and Petitioners that the Court should grant deference to the views of the FERC, it is interesting that

in this case neither the FERC nor the FERC Administrative Law Judge referred to *Northwestern* in their respective opinions. In addition, given the thoroughness of their examination of the legal issues in this case, it is particularly significant that neither the majority of the Court of Appeals nor concurring Judge Mikva in this case referred to *Northwestern*.

We submit that the references in the briefs of the Petitioners and Federal Respondents to this Court's decision in *Northwestern* do not correctly reflect the narrow holding of this Court in that case and the background of that holding.

Acting under Section 301(a) of the FPA, in 1936 the FPC prescribed a uniform system of accounts for electric utilities and licensees and ordered such utilities to reclassify their electric plant accounts in accordance therewith and to submit adjusting entries necessary to reflect that reclassification as of January 1, 1937. After Northwestern submitted a purported reclassification, the FPC found that such reclassification included an item of $3,500,000 which was a "write up" for which the utility had received no value and directed that it be eliminated by the utility over time by applying all its net income above preferred stock dividend requirements against such "write-up."[11] *Northwestern Electric Co.*, 2 FPC 327 (1940), 3 FPC 83 (1942). Nowhere in those lengthy opinions of the FPC nor in the procedural orders reported in that *Northwestern* docket at 2 FPC 784, 853, 859, and 924 was there any reference to Section 318 of the FPA.

Upon separate appeals, the two orders of the FPC were affirmed by the Court of Appeals for the Ninth Circuit. *Northwestern Electric Company v. Federal Power Commission*, 125 F. 2d 882 (9th C.A., 1942), 134 F. 2d 740 (9th C.A., 1943).

[11] The FPC stated that it would have been entirely proper to order the $3,500,000 to be charged *at once* to *Northwestern's* earned surplus, but that it did not do so because that would have created a large deficit in Northwestern's surplus which, in the light of an earlier HCA order of the SEC (*Northwestern Electric Company*, 6 SEC 57 1939), would have precluded the payment of dividends to the holders of Northwestern's preferred stock, who had paid $4,800,000 into Northwestern (in contrast to the common stockholders who had paid nothing.) 2 FPC at 343-4; 3 FPC at 86.

Nowhere in the opinions of the Ninth Circuit was there any reference to FPA Section 318.

In its Petition to this Court for a writ of *certiorari*, *Northwestern* urged that "the method of write-off ordered by the [FPC] is invalid in that it involves an unlawful assumption by the Commission of jurisdiction over the payment of dividends by *Northwestern* and over a corporate reorganization of Northwestern," on the ground that HCA Section 11 granted powers to the SEC with respect to reorganizations and HCA §12(c) vests in the SEC jurisdiction over the payment of dividends and that FPA Section 318 excluded the FPC from the exercise of such jurisdiction.[12]

After *certiorari* was granted, the Department of Justice informally requested a statement by the SEC with respect to the conflicts of jurisdiction asserted by *Northwestern*. The 10-page printed letter, December 10, 1943, from SEC Chairman Purcell (plus 24 printed page attachment) responding to that request was Appendix D to the FPC's brief on the merits in that case and is now heavily relied upon and is quoted, in part, in the brief of the Federal Respondents in this case (at 14, 15, 26). However, they apparently do not recognize the key element in Chairman Purcell's analysis, even though they quote it in part.

In that letter, Chairman Purcell stated that:

> "Not all of the provisions of the [HCA] are self-operative, however; and in the absence of rules, regulations or orders of the S.E.C. implementing *such* provisions of that Act, these provision neither compel nor prohibit any action. Until the SEC does by rule or order impose 'requirements' pursuant to the sections *which are not-self-operative*, there can be no conflict of requirements and Sec. 318 does not apply." (emphasis supplied)

He then noted that all of the argument of the Petitioners in *Northwestern* as to "alleged conflicts between the *jurisdictions* of the F.P.C. and S.E.C. relates to sections of

[12] Petition at 30-31.

the [HCA] which are not self-operative," namely, Sections 15(a), 20, 12(c) and 11(b), and he proceeded to point out, in detail, that there were no orders or rules of the SEC thereunder which conflicted with the FPC's action in *Northwestern*.

As Chairman Purcell's letter noted, the HCA provisions relating to accounts and other HCA provisions he identified in that letter are not self-operative. By contrast, HCA Section 13(b) is a requirement which is self-operative in the sense employed by Chairman Purcell: unless an exemption is granted, it prohibits the entry into, or the taking of any step in the performance of, a service, sale or construction contract by a subsidiary of a registered holding company for an associate company except in accordance with such terms as the SEC prescribes to insure that such contracts are performed at cost fairly and equitably allocated. The orders of the SEC (J.A., pages 76-96) authorizing (1) the issuance and sale of common stock by SOCCO and the acquisition of such SOCCO common stock by OPCO, (2) the development and mining by SOCCO of the coal reserves acquired by it for sale exclusively to companies in the American Electric Power System, (3) the transfer of investment in coal mining development and associated facilities to OPCO and related matters, and (4) the financing of OPCO, granted the actual authorization required under HCA Section 13(b) for OPCO to engage in such transactions with OPCO. By reason of HCA Section 13(b) such transactions were required to be conducted at cost. Consequently, employing Chairman Purcell's analysis, while FPA Section 318 would not have been applicable in the *Northwestern* case, it is applicable in Ohio Power's present case.

The opinion of this Court in *Northwestern* did not treat the last-stage effort of the utility to invoke FPA Section 318 as worthy of any detailed analysis. Instead, the Court simply stated (321 U.S. at 125):

> "The petitioners attack the regulations as in conflict with the powers and the regulations of the Securities and Exchange Commission, which also has regulatory power over Northwestern; but an examination of the statute and of the orders and proceedings of the Securities and Exchange Commission satisfies us that no conflict exists."

Given the circumstances of the Court's decision, we do not urge that its holding in *Northwestern* provides compelling support for our position here. We do assert, however, that it provides better support for our position than for the position of the Federal Respondents.

B. *Appalachian Power Co. v. FPC*, 328 F. 2d 237 (4th Cir., 1964), *cert. denied*, 379 U.S. 829 (1964)

The brief of the Federal Respondents, in summarizing (at 26-27) the holding of the Fourth Circuit in *Appalachian Power Co.*, ignores the fact (discussed above) that, in relation to the keeping of accounts and accounting matters, HCA Section 20(b) provides that the rules, regulations and orders of the SEC in respect of accounts shall not be inconsistent with the requirements imposed by the FPA or any rule or regulation thereunder. In that area dual jurisdiction under the HCA and FPA is expressly authorized by the HCA.

That *Appalachian* case involved proceedings initiated by the FPC by an order directing Appalachian to show cause why its accounting practices should not be found in violation of the FPC's Uniform System of Accounts—a matter in which, by reason of HCA Section 20(b), the jurisdiction of the FPC was not pre-empted by FPC Section 318. Moreover, that case involved a subject in which the relevant HCA grant of jurisdiction to the SEC (in Sections 15 and 20(a)) was not self-operative. Rather, to the extent that the SEC had exercised its jurisdictional powers with respect to that subject as applicable to the issue involved in *Appalachian*, the SEC had done so by approving the use of the balance sheet captions and classifications prescribed by Order 204 of the FPC.

In its opinion in *Appalachian*, the Court of Appeals also referred (at 250) to the letter of SEC Chairman Purcell appended to the brief of the Solicitor General in the *Northwestern Electric Co.* case discussed above. Our comments in that context in connection with *Northwestern*, are also applicable in the context of the *Appalachian* case.

C. *George B. Evans*, 1 FPC 511 (1937) *Olcott Falls Co.*, 3 FPC 310 (1942)

The Federal Respondents brief asserts (at pages 18 - 19, 32) that "[t]he roots of FERC's 'actual conflict' position date back to just after the enactment of the FPA," citing *In re George B. Evans* and *In Re Olcott Falls Co.* However, those decisions and subsequent decisions do not support the gloss now given to them by the Federal Respondents' brief.

For an understanding of those (and subsequent) decisions, it is necessary to review briefly the interaction of several provisions of the HCA and the FPA, having to do with (1) the issuance of securities and assumption of liabilities by a registered holding company and/or subsidiary thereof, (2) the acquisition of utility assets by a registered holding company and/or subsidiary thereof, and (3) the disposition by a registered holding company and/or subsidiary thereof, by sale or lease of utility assets or utility securities. In *Evans* and *Olcott Falls*, the FPC recognized that, if the SEC had jurisdiction under the HCA of all aspects of the transaction, the FPC would not have any jurisdiction by reason of FPC Section 318. On the other hand, if the SEC had jurisdiction under the HCA with respect to one side (*e.g.*, a purchase of utility assets by a subsidiary of a registered holding company) but did not have jurisdiction under the HCA with respect to the other (*e.g.*, the sale of utility assets by a subsidiary of a registered holding company), then the FPA could have jurisdiction under the FPC with respect to such sale.

In *Evans* (and in the related SEC proceedings, *Laclede Power & Light Company*, 2 SEC 466 (1937)), both the SEC and FPC recognized that the SEC had jurisdiction (i) under HCA Sections 6 and 7 with respect to the issuance by Laclede of securities and the assumption of liabilities, and (ii) under HCA Sections 9 and 10 with respect to the acquisition by Laclede of utility assets, and the FPC expressly conceded (at 520) that this was the "result of the operation of section 318" of the FPA. However, at that time it was assumed (without discussion in the FPC and SEC opinions) that the SEC did not have jurisdiction with respect to the sale and lease of the utility

facilities there involved and, therefore, that the FPC had jurisdiction of such sale and lease under FPA Section 203. That assumption was also involved in the application under FPA Section 203 by *Olcott Falls Company* to the FPC for authority to sell its utility assets to Bellow Falls Hydro-Electric Falls Company, a subsidiary of a registered holding company.

That assumption stemmed from HCA Section 12(d) which provides in pertinent part:

> "It shall be unlawful for *any registered holding company* . . . to sell . . . any utility assets, in contravention of such rules and regulations or orders . . . as the [SEC] deems necessary or appropriate in the public interest . . ." (emphasis supplied)

Initially, there was a question as to whether HCA Section 12(d) applied to a sale by a subsidiary (as distinguished from a registered holding company) of utility assets. However, the SEC soon adopted Rule U-12D-1 under the HCA. That Rule required the filing of a declaration under HCA Section 12(d) for authorization of the SEC for the "direct or indirect sale" of utility assets by a registered holding company. In 1938 the SEC held that, in some such transactions, the subsidiary was merely an agent for its registered holding company parent, that the sale was, therefore, an indirect sale by the registered holding company parent, and that the SEC thus had jurisdiction over such a sale pursuant to HCA Section 12(d) and SEC Rule U-12D-1. See *Kentucky-Tennessee Light and Power Company*, 4 SEC 206 (1938); *Iowa Public Service Company*, 6 SEC 435 (1939). That position was strengthened in the SEC's Rule 44 adopted under the HCA more than forty years ago and has not been effectively challenged since then.

Olcott Falls involved an additional aspect relating to the acquisition side of a transaction. Section 9(a) of the HCA generally requires SEC authorization under HCA Section 10 for the acquisition of utility assets by a registered holding company or subsidiary thereof. However, HCA Section 9(b)(1) provides that such SEC authorization is not required for the acquisition by a public utility company of utility assets the

acquisition of which has been expressly authorized by a State Commission. If the acquisition by Bellows Falls of the Olcott Falls utility assets was expressly authorized by a State commission and, by reason of HCA Section 9(b)(1), did not require SEC authorization, FPC authorization of such an acquisition would have been required under FPA Section 203. In its *Olcott Falls* decision, 3 FPC at 312, the FPC stated that the decision on that matter was to be made in the first instance by the SEC and that it was not acting on the matter of such acquisition until a decision had been made by the SEC.

Subsequently, in *Bellows Falls Hydro-Electric Corporation*, 12 SEC 341 (1942), the SEC approved an application under HCA Section 12(d) by the parent of Olcott Falls to sell the subject utility assets, as well as the application of Bellows Falls under HCA Section 10 to acquire such assets, so that, ultimately, there was no need for FPC authorization of either side of the transaction.

We suggest that a fair reading of the FPC decisions in *Evans* and *Olcott Falls* is that the FPC recognized very early on that its *jurisdiction* was limited by FPA Section 318 and that the FPC had jurisdiction in connection with the purchase or sale of assets or the issuance of securities only with respect to those aspects of such transactions that were not subject to SEC jurisdiction under the HCA. Nothing in those decisions of the FPC (or in the related decisions of the SEC) suggests that they were premised on the "actual conflict" or "dual and concurring jurisdiction" positions now espoused by the Federal Respondents.

D. *Appalachian Elec. Power Co.*, 27 SEC 1029 (1948)

This decision involved a proceeding in which the SEC approved an application relating to the formation of two new subsidiaries of a registered holding company, American Electric Power, parent of Appalachian Electric Power Company and Ohio Power Company. Appalachian and Ohio Power were each financing and constructing a new generating unit which were capable of being operated together as a single station. One of those new subsidiaries, Central Operating Company,

was to operate these new generating units: the other, Central Coal, was to supply coal to those units at cost. The SEC order recited (at 1032 and 1035) that the record before it stated that the contract between *Central Operating* and the two affiliated utilities for which it was to operate the generating units was subject to approval by the FPC. However, it is noteworthy that that SEC order does not contain a similar statement with respect to *Central Coal*, which presents a situation precisely similar to that here presented.[13] Thus, the material from the SEC's decision in *Appalachian* quoted at page 17 of the Federal Respondents' brief is not applicable to OPCO's coal purchases from OPCO.

The FERC's Opinion 272 in 1987 constituted a radical departure from the practice employed by it for the preceding forty-one years. Beginning at least as early as 1946, the SEC authorized the formation of coal mining subsidiaries to sell coal to OPCO priced at cost (including a reasonable return on OPCO's investment in such companies). See *Ohio Power Company*, Holding Company Act Release No. 7031 (1946), Holding Company Act Release No. 8079 (1948); *Appalachian*, *supra* (1948). Although occasionally questioned by members of the FERC staff, the pricing of such sales to OPCO in conformity with SEC authorization was not disturbed by the FERC until Opinion 272 was issued.

E. *Savannah Elec. & Power Co.*, 42 Fed. Energy Reg. Comm'n Rep (CCH) ¶ 61,240 (1988)

Central Illinois Pub. Ser. Co., 42 Fed. Energy Reg. Comm'n Rep (CCH) ¶ 61,073 (1988)

The brief of the Federal Respondents is correct in stating (at 18) that the "FERC has *recently* taken the same position" (emphasis supplied) in other cases (citing *Savannah* and *Central Illinois*) as it took in 1987 in Opinion No. 272. How-

[13] Instead, the SEC order stated (at 1034):

> "Our approval herein should not be construed as precluding further action by any proper regulatory authority with *respect to the return of Appalachian and Ohio on their investment in Central Coal.*" (emphasis supplied)

ever, it should be noted that, in these 1988 cases, the FERC, after asserting jurisdiction, authorized the transactions on the merits so that there was no occasion for judicial review. Thus, the unreviewed assertions of jurisdiction by the FERC in *Savannah* and *Central Illinois* (which the Group believes were incorrectly decided and which reversed earlier decisions[14]) provide no substantive support for its *1987* decision here involved.

III. The Views Attributed to the FERC and SEC in the Federal Respondents' Brief are not Entitled to Deference Under *Chevron*

The Federal Respondents' brief (at 14 and elsewhere) asserts that "the long-standing interpretation by both the SEC and FERC requiring actual conflict before Section 318 ousts FERC jurisdiction is entitled to substantial deference."[15] However, as we have previously demonstrated, the FERC did not in Opinion 272 even refer to, let alone rely upon, the decisions which the Federal Respondents' brief now asserts establish the "long standing interpretation by both the SEC and FERC." Since a court cannot affirm an agency decision on a ground other than that articulated by the agency, those decisions do not provide a basis for the deference to which the Federal Respondents now lay claim. Moreover, as we have demonstrated by analysis of each of the decisions cited by the Federal Respondents, those decisions do not support the Federal Respondents' position in this case. Rather, what emerges is that it was not until this case that the FERC elected to challenge

[14] *Iowa Power & Light Co.*, 9 Fed. Energy Reg. Comm'n (CCH) ¶61,099 (1980); *Sierra Pacific Power Co.*, 27 Fed. Energy Reg. Comm'n (CCH) ¶61,081 (1984); *Texas-New Mexico Power Co.*, 28 Fed. Energy Reg. Comm'n, ¶61,079 (1984) and *Iowa Southern Utilities Company*, 35 Fed. Energy Reg. Comm'n ¶61,149 (1986)

[15] In *Judicial Deference to Administrative Interpretations of Law*, 1989 Duke Law Journal 511, Justice Scalia pointed out (at 517) that under *Chevron* "there is no longer any justification for giving 'special' deference to 'long-standing and consistent' agency interpretations of law."

directly the actual terms of FPC Section 318, and then subsequently (and incorrectly) proceeded to apply its rationale in this case to other cases then pending before it.

The Federal Respondents' brief also ignores the most fundamental aspect of *Chevron*, namely,

> "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."

Chevron, U.S.A. Inc. v. NRDC, 467 U.S. 837 at 842 (1984).

For the reasons set forth above, we submit that the intent of Congress in FPA Section 318 is made clear by its express terms and by its legislative history and that the passage of more than a half century since its enactment has not obscured that clear intent.

CONCLUSION

The position advanced in the Federal Respondents' brief attempts to blur and confuse two separate issues, namely:

1. Does the FERC have jurisdiction to prescribe a price for the coal sold to OPCO by SOCCO other than the "at-cost price, fairly and equitably allocated" required by HCA Section 13(b)?

For the reasons discussed above, we submit that the FERC has no such jurisdiction.

2. Assuming that the FERC has no jurisdiction to require that SOCCO sell such coal to OPCO at a price other than "at cost," in fixing OPCO's rates is the FERC free to ignore the payments actually made by OPCO to SOCCO in accordance with HCA Section 13(b)?

Concurring Judge Mikva agreed with his colleagues that the "FERC and SEC are clearly regulating the same subject matter, namely, the price of coal between Ohio Power and

Southern Ohio." He simply questioned whether HCA Section 13(b) and/or the SEC orders required an at-cost price. If they did, he would have joined the majority of the Court of Appeals who regarded such pricing as binding upon the FERC.

The Federal Respondents in their brief disagree. They assert that, in the light of the "difference in the goals and expertise" of the two agencies, the FERC is free to disregard the fact that the payments were actually made by OPCO to SOCCO over a period of many years and reflected SOCCO's costs fairly and equitably allocated. They also assert (at 23) that this Court's decisions in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) and *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354 (1988) have no bearing in this case because they

> " . . . were not based on concerns that 'cost trapping' would result from permitting concurrent state ratemaking review."

We find no basis for such a crabbed reading of those decisions.

Those decisions were based in part on the filed rate doctrine. But, more broadly, as stated by this Court (*Nantahala*, at 966):

> "Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC - approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give FERC plenary authority . . . and to ensure that the States do not interfere with this authority."

In the same way, as the Court made clear in *Nantahala* and *Mississippi Power & Light Company v. Mississippi*, 487 U.S. 354 (1988), in the event of an increase in the price of OPCO's purchases at cost of coal from SOCCO, such increases in OPCO's coal purchase costs need not necessarily lead to an

increase in the rates OPCO charges to its wholesale customers. But such a divergence from the need to reflect such increased coal costs in OPCO's rates to its wholesale customers could occur only if OPCO's costs (other than those resulting from the purchases of coal at SOCCO's costs as prescribed by HCA Section 13(b)) were to decrease. *Nantahala*, at 967; *Mississippi Power & Light* at 56 U.S.L.W. 4751, 4756 (U.S. June 24, 1988).

In this *Ohio Power* case it is clear that there is no occasion to consider the possibility of offsetting decreases in other costs, since all issues in the FERC proceeding had been settled except the extent to which OPCO could include its costs for "captive coal" purchased from SOCCO in its recoverable cost of service. *Ohio Power Co. v. FERC*, 880 F. 2d 1400, 1404; *Ohio Power Co.*, 39 FERC ¶61,098, at 61,274 (1987).

We do not, of course, dispute that in some respects there are important differences in the roles and focus of the SEC under the HCA and those of the FERC under the FPA, as illustrated by *City of Lafayette v. SEC*, 454 F. 2d 941 (D.C. Cir. 1071), aff'd *sub nom. Gulf States Utilities Co. v. FPC*, 411 U.S. 747, 754-755 (1973). But, in FPA Section 318, Congress explicitly recognized that, given the manner in which the two Acts had been independently developed, there was a potential for duplicative regulatory action by the SEC and the FERC with resulting burdens on government and utilities. Congress, therefore, in FPA Section 318 specifically limited the FERC's jurisdiction (except with respect to accounting matters) so as to eliminate that potential.

As discussed throughout this brief, FPA Section 318 denies jurisdiction to the FERC under the FPA only when (1) there is a provision of the HCA which is "self-operative" (in the sense employed by Chairman Purcell), or (2) there is a provision of the HCA which has been implemented by a rule, regulation or order of the SEC and, even then, the FERC is not denied jurisdiction with respect to accounting matters. The spectre of possible "regulatory gaps" conjured

up at page 14 of the Federal Respondents' brief is unsupported[16] and assumes that the SEC and FERC will not adequately discharge their responsibilities.

For the foregoing reasons, the decision of the United States Court of Appeals for the District of Columbia Circuit should be affirmed.

Respectfully submitted,

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[16] In the case of HCA Section 13(b), for example, the SEC has repeatedly demonstrated the exercise of continuing supervision not only by periodic audits of service company operations but in requiring that no change be made in the organization of an approved service company, in the type and character of the companies to be serviced, in the method of allocating costs to associate companies or in the scope or character of services without prior filings with the SEC. See, *e.g.*, *Allegheny Power Service Corporation*, HCA Release No 15469 (1969), *Middle South Services, Inc.*, HCA Release No. 15207 (1965), *Entergy Corporation*, HCA Release No. 25100 (1990). Similarly, in a series of more than 20 orders over a period of 15 years, the SEC has exercised comprehensive oversight of the creation, financing and operation of New England Energy, Inc., the oil and gas subsidiary of New England Electric System, *e.g.*, *New England Electric System*, HCA Release No. 18635 (1974) through *New England Energy, Inc.*, HCA Release No. 25008 (1989) and has required quarterly reporting of the financial condition and transactions completed since the inception of the program.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,
v.
OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF THE INDIANA MUNICIPAL POWER AGENCY AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONERS

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QUESTIONS PRESENTED

1. Whether the lower court erroneously failed to accord any deference to agency interpretation of a statutory scheme, where

   (a) the scheme consists of two statutes (the Federal Power or FPA and the Public Utility Holding Company Act or PUHCA), administered by two agencies (the Federal Energy Regulatory Commission or FERC and the Securities and Exchange Commission or SEC, respectiveiy), which function together to regulate interstate public utility holding companies; and

   (b) the lower court's ruling as to the jurisdiction of each agency is inconsistent with the manner in which both agencies have interpreted and administered the relevant statutory provisions since the FPA and PUHCA were enacted more than half a century ago.

2. Whether the lower court erroneously interpreted FPA Section 318 and PUHCA Section 13(b), through misapplication of preemption principles and this Court's decision in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), in holding that the FERC is without jurisdiction to ensure that the rates of a public utility affiliated with a holding company include only just and reasonable payments made to affiliated suppliers of fuel and other goods and services used to produce electricity, even when the SEC has not scrutinized or determined the reasonableness of those purchases.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1283

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF THE INDIANA MUNICIPAL POWER AGENCY AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONERS

The Indiana Municipal Power Agency (IMPA), pursuant to Rule 37 of the Rules of the Supreme Court of the United States, hereby submits this brief as *amicus curiae*, in support of the Petitioners in this proceeding, the Village of Arcadia, Ohio, *et al.* IMPA seeks reversal of the decision below, *Ohio Power Company v. FERC*, 880 F.2d 1400 (D.C. Cir. 1989).[1]

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[1] Consent of the parties is not required for the filing of this brief, because IMPA is a political subdivision of the State of Indiana, and IMPA is represented here by its General Counsel as well as by outside counsel (Rule 37.5).

INTEREST OF THE INDIANA MUNICIPAL POWER AGENCY

IMPA was formed as a political subdivision of the State of Indiana, pursuant to Indiana Code § 8-1-2.2, to serve as an electric power supply and planning agency for municipalities which own and operate retail electric distribution systems. IMPA currently consists of 31 Indiana cities and towns.[2] IMPA purchases wholesale electric power from Indiana Michigan Power Company (I&M), which is an operating company subsidiary of the American Electric Power Company, Inc. (AEP). AEP is a registered public utility holding company subject to the jurisdiction of the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act (PUHCA). I&M's wholesale rates to IMPA are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC) under the Federal Power Act (FPA).

The opinion below addressed the respective jurisdictions of the FERC and the SEC regarding the regulation of the cost of coal purchased by another operating company subsidiary of the AEP system, Ohio Power Company (Ohio Power), from a fuel subsidiary. The panel majority concluded that Section 318 of the FPA, 16 U.S.C. § 825q, deprives the FERC of jurisdiction to disallow that portion of the payments made by Ohio Power to its subsidiary which was in excess of the price of comparable coal in the market, when Ohio Power sought to include the cost of the payments in its wholesale electric rates.

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[2] The members of IMPA are the cities and towns of Advance, Anderson, Bainbridge, Bargersville, Centerville, Columbia City, Covington, Crawfordsville, Darlington, Edinburgh, Flora, Frankfort, Frankton, Greendale, Greenfield, Jamestown, Ladoga, Lawrenceburg, Lebanon, Linton, Middletown, Paoli, Pendleton, Peru, Renssalaer, Richmond, Rising Sun, Scottsburg, Tipton, Washington and Waynetown, Indiana.

Inter-affiliate transactions can be a significant component of the costs of a public utility holding company. For example, AEP, through its operating companies, has invested not only in affiliate coal mining operations, but in related fuel supply equipment and facilities, including a fleet of river towboats, approximately 500 coal barges, more than 3000 rail-hopper cars for transporting coal, and a rail-to-barge coal transfer terminal on the Ohio River with the capacity of transferring in excess of 12 million tons of coal annually. As a purchaser from an operating company subsidiary of a registered public utility holding company, IMPA has a direct interest in preventing the imposition of unwarranted restrictions upon the exercise by the FERC of its jurisdiction to regulate the wholesale electric rates of such operating company subsidiaries for the protection of consumers.

INTRODUCTION AND SUMMARY OF ARGUMENT

In the opinion below, the majority vacated a decision of the FERC, reached after a full adjudicative hearing and on the basis of an extensive record, disallowing in Ohio Power's wholesale rates a portion of the payments made to its affiliated coal supplier, Southern Ohio Coal Company (SOCCO), because the price substantially exceeded the market price of comparable coal available from non-affiliated suppliers. The FERC concluded that this disallowance was necessary to ensure that Ohio Power's rates were just and reasonable, pursuant to Sections 205 and 206 of the FPA, 16 U.S.C. §§ 824d and 824e, because the utility had incurred unreasonable and excessive fuel costs by purchasing coal from an affiliate. Relying on its earlier determination in *Public Service of New Mexico*, 17 F.E.R.C. ¶ 61,123 (1981), *aff'd*, 832 F.2d 1201 (10th Cir. 1987), the FERC explained that the application of a market-price test protects ratepayers from costs of self-dealing without requiring detailed scrutiny of the affiliate transactions themselves, and provides an incentive for utilities to develop lower-cost sources of fuel. *Ohio Power*

Co., 39 F.E.R.C. ¶ 61,098 at pp. 61,278-79 (Pet. Cert. App., pp. 42a-43a).[3] *See also* the initial decision of the FERC Administrative Law Judge in the *Public Service Co. of New Mexico* proceeding, which observed that a utility's fuel purchases from affiliates should be subjected to a market-price test because "public utilities are required to operate with all reasonable economies and exclude expenses which are unnecessary, inefficient, or imprudently incurred." 13 F.E.R.C. ¶ 63,041 at p. 65,171 (1980) (*citing Acker v. United States*, 298 U.S. 426 (1936); *El Paso Natural Gas Co. v. FPC*, 281 F.2d 567 (5th Cir. 1960)).

In several orders issued prior to the FERC's rate opinion, the SEC had approved Ohio Power's injection of capital into and transfer of assets to SOCCO, in order to develop certain coal reserves. The orders were issued under sections of PUHCA requiring SEC approval for most changes in corporate structure, transfers of assets, and issuances of securities by registered holding companies and their affiliates. The SEC did not cite Section 13(b) of PUHCA, 15 U.S.C. § 79m, as authority for any of the orders. It did note that under that provision SOCCO's price for coal sold to Ohio Power would be "based on" or would "not exceed" SOCCO's actual costs. 880 F.2d at 1404 (Pet. Cert. App., pp. 5a-6a). In one order, the SEC required the companies to file information on amounts of coal sold, and the price and cost. *Id.* The SEC, however, never addressed the issue which was the basic subject of the subsequent FERC proceeding: the coal supply alternatives available to Ohio Power and the reasonableness of purchasing coal from SOCCO in light of the price of that coal (*i.e.*, SOCCO's cost of producing it) and the market alternatives. Nor was that matter even raised in the summary SEC proceedings.

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[3] "Pet. Cert. App." refers to the Appendices to the "Petition for a Writ of Certiorari . . ." filed by the Village of Arcadia, Ohio, *et al.* on February 9, 1990.

In response to Ohio Power's argument that Section 318 of the FPA precluded disallowance of any of its affiliated coal costs, the FERC concluded that the SEC's orders and PUHCA Section 13(b) did not affect its ability to set just and reasonable rates for Ohio Power, and that in any event there was no conflict between the SEC's orders and the FERC's application of the market-price test. 39 F.E.R.C. at pp. 61,276-78 (Pet. Cert. App., pp. 36a-40a). Judge Mikva scrutinized the SEC orders and also found no conflict. 880 F.2d at 1411-12 (Pet. Cert. App., 21a-23a). The majority below ruled, however, that the FERC was required to permit Ohio Power to charge its ratepayers for the full cost of the SOCCO coal, regardless of what action had been taken by the SEC, and regardless of whether the SEC took any action.

The majority held that the FERC, by disallowing from Ohio Power's rates the above-market portion of the price paid to SOCCO, had addressed the same "subject matter" as PUHCA Section 13(b): "[t]he price term of sales contracts between associated companies." 880 F.2d at 1406 (Pet. Cert. App., p. 9a). According to the court, therefore, Ohio Power was subject to both a requirement of PUHCA (Section 13(b)) and a requirement of the FERC under the FPA, as to that subject matter. The court concluded that the language of FPA Section 318 operates to divest the FERC of jurisdiction, whether or not the SEC has issued any order that actually conflicts with a FERC action. *Id.* at 1408 (Pet. Cert. App., pp. 14a-15a).

To support its analysis, the majority below analogized to this Court's preemption holdings in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). On the basis of those cases, and a broad reading of PUHCA Section 13(b) as delegating to the SEC the task of protecting electric consumers from unreasonable inter-affiliate transactions

within registered holding company systems,[4] the court concluded that FERC disallowance of any portion of the cost of inter-affiliate transactions would constitute an impermissible "trapping" of costs which are only subject to regulation by the SEC. 880 F.2d at 1406, 1409 (Pet. Cert. App., pp. 9a-11a, 16a-17a).

The lower court's decision should be reversed. It overturns a half century of the administration of PUHCA by the SEC and the administration of the FPA by the FERC.[5] Both agencies have consistently adopted the view that the FERC is not ordinarily barred by FPA Section 318 from disallowing, as excessive, imprudent, or otherwise unreasonable, costs incurred pursuant to a utility's purchases of goods and services from an affiliate within a registered holding company system. The SEC has generally confined itself under PUHCA Section 13(b) to a comparison of the affiliate supplier's price with that supplier's costs. It has not asserted or exercised jurisdiction over the broader question typically considered by the FERC and, in the case of retail rates, by the state commissions: whether it is reasonable for the holding company's operating subsidiary to engage in a transaction given the alternatives. If allowed to stand, the decision below threatens to create a substantial regulatory gap which will injure consumers of electricity across the Nation. Indeed, the harm resulting from the ruling below may extend beyond inter-affiliate transactions in goods and services; the court's reasoning implies that the FERC and state commissions are divested of jurisdiction to regulate any "subject matter" which is identified in PUHCA, regardless of what action has or has not been taken by the SEC.

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[4] Except for sales of electricity and natural gas, which are exempted from SEC regulation under PUHCA Section 2(a)(20), 15 U.S.C. § 79b(a)(20).

[5] And the FERC's predecessor, the Federal Power Commission.

IMPA respectfully submits that the lower court's willingness to brush aside a regulatory scheme that has been developed over 50 years, by two agencies working in concert, is contrary to the teaching of *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

Even if no deference is accorded to the SEC's and the FERC's consistent administration of the statutes, the lower court's interpretation of FPA Section 318 and PUHCA Section 13(b) is implausible. In essence, the court read PUHCA Section 13(b) as conferring exclusive jurisdiction on the SEC to determine the reasonableness, for ratemaking purposes, of Ohio Power's acquisition of fuel from affiliates. IMPA submits that the statutes cannot reasonably be interpreted as delegating to the SEC rather than the FERC jurisdiction over that subject matter, or over any subject matter which is an essential part of the rate-making process. The majority's use of *Nantahala Power & Light Co. v. Thornburg*, *supra*, is based on an incorrect analogy between the FERC (in its relation to state retail commissions) and the SEC (in its relation to the FERC). Congress delegated the regulation of public utility holding companies to two federal agencies, with jurisdiction over largely distinct but complementary subject matters: the SEC, with principal responsibility over corporate structure and financings, and the FERC, with principal responsibility over utility rates, services and operations in interstate commerce. Section 318 serves the function in this system of ensuring that inconsistent requirements are not imposed on any person by the SEC and the FERC, as to subject matters over which they have concurrent jurisdiction. That provision divests the FERC of jurisdiction when there is an actual conflict with a requirement of PUHCA or the SEC. *Cf. Northwestern Electric Co. v. FPC*, 321 U.S. 119, 125 (1944).

Reasonably interpreted, Section 13(b) of PUHCA and the SEC's rules and orders do not impose any requirement

on Ohio Power which invalidates the FERC's orders under FPA Section 318. Even if Section 13(b) is read to impose obligations on Ohio Power rather than on SOCCO alone, the subject matter addressed by that provision, and by the SEC in its regulations and orders addressing the SOCCO-Ohio Power relationship, is not the same as the subject matter addressed by the FERC in determining the reasonableness of Ohio Power's rates. Alternatively, as concluded by Judge Mikva below, even if PUHCA Section 13(b) and the FERC addressed the same subject matter, they did so in a consistent manner, because Section 13(b) and the SEC's rules and orders at most set a ceiling on the price of SOCCO coal.

ARGUMENT

I. THE DECISION BELOW UPSETS 50 YEARS OF SEC AND FERC/FPC DECISIONMAKING

The lower court concluded that it should not defer to the FERC's interpretation of FPA Section 318 because what was at issue was that agency's jurisdiction. 880 F.2d at 1405 (Pet. Cert. App., p. 8a). However, the majority's action was more radical than this characterization might suggest. The court disregarded the interpretation of FPA Section 318 and PUHCA Section 13(b) that has consistently been employed by *both* agencies entrusted by Congress with administering the statutes it enacted simultaneously in 1935.

The FERC's view that its mandate to ensure just and reasonable rates includes the power and the obligation to scrutinize holding company inter-affiliate payments is not of recent vintage. Prior to the development of the market-price test that was applied to Ohio Power, the FERC's predecessor, the FPC, required public utilities to eliminate from their books and their rates excessive payments made to supplier affiliates. The FPC's "no

profits to affiliates" rule was applied to operating utilities within holding company systems, even though sales to such utilities by affiliated service companies and fuel suppliers were subject to regulation by the SEC under PUHCA. *E.g., California Oregon Power Co. v. FPC*, 150 F.2d 25, 27-28 (9th Cir. 1945), *cert. denied*, 326 U.S. 781 (1946).[6]

In opposing the petition for certiorari, Ohio Power acknowledged the FERC's authority to eliminate profits to affiliates from rates, and argued that the FERC's orders under review were invalid under FPA Section 318 because a market-price rather than cost standard was applied to the Ohio Power-SOCCO transactions. Brief in Opposition of Respondent Ohio Power Company, March 12, 1990, at 11 & nn.7-8. *See also id.* at 9. However, the lower court held not that the FERC used an incorrect standard in assessing the justness and reasonableness of Ohio Power's payments to its affiliate, but that the FERC lacked jurisdiction over that subject matter.

The majority below incorrectly concluded that the SEC's pronouncements are consistent with ousting the FERC of jurisdiction to disallow the cost of holding company affiliate fuel purchases in rates. To the contrary, in numerous orders stretching from the 1940's through the 1980's, the SEC has taken the view that it is the FPC/FERC, and not itself, that has jurisdiction to determine whether costs incurred by public utilities pursuant to intra-holding company transactions subject to SEC jurisdiction under PUHCA should be reflected in rates.

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[6] The FPC originally developed the "no profits to affiliates" rule in the early 1930's, in regulating hydroelectric licenses under the Federal Water Power Act of 1920 (now Part I of the FPA). After the enactment of the Public Utility Act of 1935, the FPC applied this rule to the regulation of interstate electric utilities. *California Oregon Power Co. v. FPC*, 150 F.2d at 27.

In *Central and South West Fuels, Inc.*, Holding Company Act Release No. 23,876, 34 S.E.C. Docket 500 (Oct. 23, 1985), the SEC considered a proposal by electric utility subsidiaries of the Central and South West Corporation to dissolve a fuel subsidiary and transfer its functions to the service company for the holding company system. In response to a concern expressed by intervenors that inflated fuel prices might result, the SEC expressly acknowledged the FERC's continuing jurisdiction:

> [N]othing in the proposed transactions will alter the statutory and regulatory pricing restrictions applicable to the sale of fuel to, or the performance of services for, affiliated operating companies. Such restrictions will continue to apply . . . as fully as they have applied . . . in the past. For example, Rules 90 and 91 [promulgated under PUHCA] limit charges for sale or services by an affiliated company to cost; Paragraph E of Section 23.23 of the Substantive Rules of the Public Utility Commission of Texas expressly limits affiliate fuel pricing to cost; and similarly, with respect to wholesale rates, under Section 35.14 of the regulations of FERC, unreasonable fuel charges by affiliated companies may result in the suspension of the fuel adjustment clause or cause an investigation by FERC on its own motion.

34 S.E.C. Docket at 503. In approving requests in the 1940's by Ohio Power and an affiliated public utility to establish a coal subsidiary, the SEC noted that its actions did not preclude ratemaking authorities from scrutinizing the transactions in question for purposes of setting rates. *Appalachian Electric Power Co.*, 27 S.E.C. 1029, 1034-35 (1948).[7] *Accord, The North American Co.*, 29 S.E.C. 521, 537 n.26 (1949) (in ruling that a holding company could retain its coal subsidiary, the SEC noted that coal

[7] The SEC added that it had the authority, under PUHCA Section 13, to take further action in the future if it determined that such action was necessary to enforce the standards of PUHCA or to protect consumers or investors. 27 S.E.C. at 1035.

prices would be scrutinized by ratemaking authorities and added that it could take action under Section 13 and other provisions of PUHCA at a later date if necessary).

In the proceeding below, the FERC relied on SEC statements in *New England Electric System*, Holding Company Act Release No. 22,309, 24 S.E.C. Docket 298 (Dec. 9, 1981), regarding a joint venture between a registered holding company and two subsidiaries to construct and operate coal transportation facilities. The lower court distinguished this case on the grounds that the SEC's discussion of the FERC's authority may have been predicated on the grant of an exemption under PUHCA Section 13(b). 880 F.2d at 1407 (Pet. Cert. App., pp. 12a-13a). This reading is incorrect. The SEC concluded that, because FERC's ratemaking jurisdiction is *independent* of PUHCA, no harm to consumers would result from a grant of exemption from PUHCA Section 13(b). The SEC stated, "Our grant of the exemption does not affect FERC's authority over rates . . .", and also observed that, in setting the wholesale rates of an operating subsidiary purchasing the transportation services, the FERC "may include either the entire cost of transportation . . ., if FERC should determine that it is just and reasonable, or some other amount." 24 S.E.C. Docket at 307-08, quoted in 39 F.E.R.C. at pp. 61,277-78 (Pet. Cert. App., pp. 39a-40a). The SEC added that the determination of the just and reasonable transportation costs of the operating utility was not its task, but FERC's: "In relying on this [FERC] ratemaking process we do not cede any of our statutory responsibilities to another agency." 24 S.E.C. Docket at 308, quoted in 39 F.E.R.C. at p. 61,278 (Pet. Cert. App., p. 40a).[8]

[8] By contrast, when the FERC approved a settlement of litigation regarding the payments by another operating utility affiliate of Ohio Power for affiliate-supplied coal, there was a conflict with PUHCA Section 13(b) because the settlement agreement specified that the coal affiliate's prices for coal sold to the utility would be based upon market prices, which were expected to exceed the coal

In *Georgia Power Co.*, Holding Company Act Release No. 23,448, 31 S.E.C. Docket 621 (Oct. 10, 1984), the SEC approved a sale of an ownership share of a generating plant under construction from one operating utility (Georgia Power Company) to another (Gulf Power Company) within the Southern Company registered holding company system. The SEC observed that, because Georgia Power would continue to construct the plant, the transaction would involve an inter-affiliate supply of construction services subject to PUHCA Section 13(b). 31 S.E.C. Docket at 623. In response to allegations by a group of retail ratepayers that Georgia Power's construction program was unreasonable and too costly, the SEC observed "that in a recent decision the Georgia [Public Service] Commission stated that . . . it will review Georgia [Power]'s construction program, and our decision today does not limit the extent of that review nor what [retail ratepayers] may submit to the Georgia Commission." *Id.* at 624 (footnote omitted).

Consistent with its interpretation of its own and the FERC/FPC's jurisdiction, the emphasis of the SEC's activities under PUHCA Section 13(b) has been to prevent suppliers affiliated with operating utilities in registered holding company systems from charging prices to those utilities in excess of the affiliates' costs. To the best of the knowledge of undersigned counsel, the SEC has only considered the broader question of the need for goods or services to be purchased by an operating utility from an affiliate, given alternative sources of supply, in the context of determining whether to approve the establishment or permit the continued existence of a service company within a holding company system (an entity supplying managerial, engineering, legal and other services to the

affiliate's costs. To eliminate the conflict and effectuate the FERC settlement under FPA Section 318, the AEP companies applied for and were granted a limited exemption from Section 13(b) by the SEC. *Blackhawk Coal Co.*, Holding Company Act Release No. 23,834, 34 S.E.C. Docket 185 (Sept. 20, 1985).

operating utilities).[9] With regard to particular transactions between affiliates, the SEC has left questions of their reasonableness to the FERC/FPC and state rate commissions.[10]

In other decisions, the SEC has observed that its jurisdiction over financing vehicles under PUCHA does not operate in conjunction with FPA Section 318 to divest the FERC or state ratemaking agencies of their authority to disallow the related costs in setting just and reasonable electric rates. *E.g., Georgia Power Co.*, Holding Company Act Release No. 18,750, 5 S.E.C. Docket 24, 25 (Dec. 31, 1974) (SEC approval of a partial sale of a nuclear plant by an operating utility subsidiary of the Southern Company does not prevent rate commissions from scrutinizing the reasonableness of the sale price under FPA Section 318); *Arkansas Power & Light Co.*, 45 S.E.C. 567, 573-74 (1974) (SEC approval of a sale and leaseback of nuclear fuel does not compel retail rate agencies or the FPC to allow the cost of the fuel in rates).

[9] *E.g., New England Power Service Co.*, 10 S.E.C. 562 (1941).

[10] The lower court relied on an SEC statement made, in the course of advocating repeal of PUHCA, in a 1982 hearing before the House of Representatives (880 F.2d at 1407; Pet. Cert. App., p. 13a). That statement must yield to the manner in which the SEC has actually administered PUHCA. Contrary to the assertion of Ohio Power (at pages 15-16 of its brief in opposition to certiorari), the fact that Congress did not amend or repeal PUHCA on the basis of this SEC statement is entitled to no weight in determining the intent of the statutory scheme established in 1935. *See Firestone Tire and Rubber Co. v. Bruch*, 489 U.S. ——, 109 S.Ct. 948, 956 (1989), where the Court declined to infer, from a failure of Congress to amend a statute to reverse an interpretation of the statute that had been adopted by almost all of the Courts of Appeals, that the lower courts' interpretation was correct. In the controversy at bar, Congress' inaction regarding PUHCA in the early 1980's is much less significant than the Congressional inaction at issue in *Firestone Tire*, because the SEC's 1982 statement on Sections 13(b) of PUHCA and 318 of the FPA was inconsistent with its actual administration of PUHCA.

In *AEP Generating Co.*, Holding Company Act Release No. 24,989, 44 S.E.C. Docket 1665 (Nov. 21, 1989), two affiliates of Ohio Power sought SEC approval of a sale and leaseback of their ownership shares of a new coal-fired generating unit, and payment by one affiliate to the parent holding company of a portion of the sale proceeds as a dividend to reduce the holding company's equity investment. The AEP companies admitted that SEC approval would not preclude the FERC from considering the reasonableness of the costs and benefits of the dividend transaction, or of the affiliates' capital structure or capital costs, and would not preclude the FERC from making cost disallowances for ratemaking purposes (so long as the FERC did not alter the specific debt interest rates, preferred stock dividend rates, and accounting treatment approved by the SEC). 44 S.E.C. Docket at 1667.

The SEC also has declared in a number of cases that its jurisdiction over security issuances and transfers of ownership shares in utility plant under PUHCA does not extend to assessments of the reasonableness of an operating utility's construction program. The agency has referred utility customers seeking to challenge the costs incurred as a result of a construction program, or the allocation of such costs among holding company system members, to the FERC/FPC or the appropriate state retail rate commission. *E.g., Georgia Power Co.*, 31 S.E.C. Docket at 624; *Georgia Power Co.*, Holding Company Act Release No. 23,330, 30 S.E.C. Docket 934, 935-36 (June 15, 1984); *The Southern Company*, Holding Company Act Release No. 21,665, 20 S.E.C. Docket 739, 801-02 (July 24, 1980); *Georgia Power Co.*, 5 S.E.C. Docket at 25. The power of the FERC/FPC to disallow such costs in the context of an inquiry into the reasonableness of a construction program has not been affected by its lack of jurisdiction,

pursuant to FPA Section 318, to approve or deny the security transaction or asset disposition or acquisition itself.[11]

The above cases present a consistent SEC interpretation of its jurisdiction under PUHCA and the FERC/FPC's jurisdiction under the FPA. With regard to inter-affiliate sales subject to PUHCA Section 13(b), and financings of new plant and transfers of plant shares subject to other provisions of PUHCA, the SEC has exercised jurisdiction over the specific sale, security issuance or other transaction addressed by PUHCA, and has left to the FERC/FPC (or the appropriate state commission, with regard to retail rates) scrutiny of the larger questions of whether the activities of operating utilities in obtaining fuel and constructing generation resources have been reasonable and have avoided unnecessary costs to ratepayers. These cases are inconsistent with the decision of the lower court in the instant case. Under the D.C. Circuit's interpretation of FPA Section 318, the FERC would be divested of jurisdiction to disallow, for ratemaking purposes, costs incurred pursuant to any transaction which is specifically identified in Section 318 —including securities transactions and acquisitions and dispositions of assets—as well as transactions such as inter-affiliate sales of coal, which are "other subject matters" identified in PUHCA.[12]

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[11] *See, e.g., Gulf Power Co.*, Holding Company Act Release No. 21,419, 19 S.E.C. Docket 506 (Feb. 5, 1980); *Oklahoma Gas and Electric Co.*, 5 F.P.C. 52, 54 (1946) (SEC jurisdiction over a securities issuance by a holding company affiliate under PUHCA divested FERC/FPC of jurisdiction under FPA Section 204 to approve or deny it); *Monongahela Power Co.*, Holding Company Act Release No. 16,423 (July 8, 1969); *Kentucky Power Co.*, Holding Company Act Release No. 15,905 (Nov. 24, 1967) (where a utility's sale of assets is subject to SEC approval under PUHCA, the FPC does not have jurisdiction under FPA Section 203 over that sale, although it would have jurisdiction over the acquisition of the assets by an independent company).

[12] PUHCA Section 13(b)'s requirement that the SEC regulate sales of goods and services to affiliates "in the public interest [and]

Thus, the SEC has not interpreted its jurisdiction under PUHCA as extending to issues pertaining to whether a utility has acted reasonably to supply electric service to wholesale or retail customers at a just and reasonable cost, such as whether it has incurred unnecessary fuel costs as a result of self-dealing or poor planning, or has failed to take reasonable steps to avoid unnecessary costs in developing new generation resources. Even if the SEC's jurisdiction extends to such subject matters, however, the lower court's interpretation of FPA Section 318 as divesting the FERC of jurisdiction over any subject matter identified in Section 318 or in PUHCA, for purposes of determining just and reasonable rates, clashes with the way the SEC and the FERC/FPC have regulated electric utilities within registered holding company systems. For instance, both the SEC and the FPC/FERC have required holding company system utilities to eliminate from their books unreasonable write-ups of assets and profits to affiliates, to prevent use of the holding company structure to overcharge customers. *E.g., Georgia Power Co.*, 31 S.E.C. Docket at 623 & nn. 11-15, and cases there cited. In litigation before this Court over the FPC's authority to require an operating utility holding company subsidiary to revise its accounts to eliminate write-ups in the value of its common stock from its cost of plant, the SEC stated, in a letter to the Solicitor General:

> Section 318 of the Public Utility Act of 1935 resolves the question of possible conflicting requirements . . . . It was not intended that utility companies should be able to thwart regulation by the F.P.C. by conjuring up under Sec. 318 imaginary conflicts with *potential* action of the S.E.C.

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for the protection of investors [and] consumers" (15 U.S.C. § 79m) also appears in the provisions governing SEC regulation of security transactions and transfers of assets. PUHCA Sections 6(b); 7(d) and (e); 9(c); 10; and 12(c), (d), (f) and (g) (15 U.S.C. §§ 79f (b); 79g(d) and (e); 79i(c); 79j; and 79*l*(c), (d), (f) and (g)).

Letter from G. Purcell, Chairman, SEC, to the U.S. Solicitor General, December 10, 1943, printed in Brief of Respondent, App. D at 98-99, *Northwestern Electric Co. v. FPC*, 321 U.S. 119 (1944) (No. 195) (emphasis in original).

In cases presenting issues of overlapping SEC and FERC/FPC jurisdiction, the SEC has taken care to fashion or modify its orders to avoid unnecessary interference with FERC/FPC authority under Section 318. *E.g., American Power & Light Co.*, Holding Company Act Release No. 9719 (March 7, 1950) (modification of prior SEC order to eliminate condition which might have limited the FPC's jurisdiction under FPA Section 204 to approve securities); *Oklahoma Gas and Electric Co.*, 22 S.E.C. 209, 219 (1946); *Oklahoma Gas and Electric Co.*, 22 S.E.C. 466 (1946) (SEC granted approval of amortization program for premiums paid on redemption of preferred stock as ordered by the FPC, to avoid affecting that agency's jurisdiction). In *Blackhawk Coal Co., supra* n.8, the SEC granted a limited exemption from PUHCA Section 13(b) in order to effectuate a settlement of FERC litigation involving the reasonableness of purchases by Indiana & Michigan Electric Company (I&M), an affiliate of Ohio Power, from a subsidiary coal supplier, Blackhawk Coal Company, in light of the availability of lower-cost coal from nonaffiliates. Under the settlement, Blackhawk was permitted to purchase coal from nonaffiliates and sell it to I&M at specified market-based prices; the excess of I&M's payments over Blackhawk's costs were to be used to amortize a portion of the investment in the Blackhawk mines. In the instant case, the Court of Appeals in effect declared that neither the FERC nor the SEC possesses the authority to take the actions that they took in the *Blackhawk* case. *See* 880 F.2d at 1408 (Pet. Cert. App., p. 15a).[13]

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[13] Unlike the FERC orders at issue in this case, the FERC settlement at issue in *Blackhawk Coal Co.* conflicted with PUHCA Section 13(b), because it provided that Blackhawk would charge and

IMPA respectfully submits that even if, as a general matter, an agency's interpretation of its statutory jurisdiction is not entitled to judicial deference, the lower court erred in this case by failing to accord any deference to this regulatory history. Judicial deference to an agency's interpretation of a statute that it administers is grounded in the principle that a reviewing court should not interfere with the authority delegated to the agency to develop the details of an administrative scheme and to develop policy within the parameters set by Congress. *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. at 843-44. The majority's ruling disrupts a regulatory system fashioned by two agencies over a 50-year period, in which the SEC, in exercising its powers under PUHCA, generally has deferred to and relied upon the FERC's or FPC's power, in setting rates, to disallow costs incurred by operating utility subsidiaries of holding companies as unjust and unreasonable. Moreover, the FERC's and SEC's longstanding implementation of FPA Section 318 and PUHCA Section 13(b) is entirely consistent with the plain meaning of those statutes.

II. THE DECISION BELOW DOES VIOLENCE TO THE STATUTORY SCHEME AND DISTORTS THIS COURT'S PRIOR HOLDINGS

The lower court rested its decision on an extremely broad and unreasonable reading of FPA Section 318 and PUHCA Section 13(b). Analogizing to the doctrine of "preemption of the field," which has been applied to bar state regulation of a subject matter which Congress intended be subject only to federal regulation, the lower court concluded that Congress intended to divest a *federal* agency, charged with ensuring just and reasonable electric rates, of jurisdiction to determine whether and to what ex-

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I&M would pay market-based prices for coal in excess of Blackhawk's costs.

tent ratepayers should bear the costs of intra-holding company transactions in fuel and other goods and services used to produce electricity. This conclusion is contradicted by the very fact that, in the 1935 Public Utility Act, Congress established a system to regulate interstate electric utilities consisting of *two* statutes and *two* agencies, with interlocking and complementary powers. The SEC was given principal authority over utility corporate structure and financing, and the FERC (formerly the FPC) was given principal authority over interstate utility operations and rates. *City of Lafayette, Louisiana v. SEC*, 454 F.2d 941, 955-56 (D.C. Cir. 1971), *aff'd on other grounds, Gulf States Utilities Co. v. FPC*, 411 U.S. 747 (1973).[14] By giving the SEC broad powers over the organization and financial transactions of holding companies, Congress intended to supplement, not supplant, regulation of utility rates and services. *See Alabama Electric Cooperative v. SEC*, 353 F.2d 905, 907 (D.C. Cir. 1965). FPA Section 318 was necessary to resolve any actual conflicts that might arise between the two agencies as to matters over which they have concurrent jurisdiction. Congress addressed the general scope of the FERC's jurisdiction over interstate utility rates and services in Section 201 of the FPA (16 U.S.C. § 824), not in Section 318. *See, e.g.*, Section 201(b)(1) (limited jurisdiction over generating or distribution facilities or transmission facilities used only for intrastate commerce), and Section 201(f) (no jurisdiction over the United States, or a state, or any political subdivision of a state).

As pointed out by Judge Mikva below (Pet. Cert. App., p. 30a), the Court of Appeals decision creates a serious regulatory gap in the system designed by Congress and implemented by the FERC and the SEC. The

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[14] This Court quoted the *Lafayette v. SEC* analysis of the allocation of authority between the SEC and the FERC/FPC in *Gulf States Utilities Co. v. FPC*, 411 U.S. at 755 n.4.

majority observed that Ohio Power's coal costs had not been scrutinized or controlled by the SEC. 880 F.2d at 1408-09 (Pet. Cert. App., p. 15a). However, the gap is more severe than the lower court acknowledged. The SEC's orders regarding Ohio Power are no anomaly; the agency has not scrutinized interaffiliate sales and service transactions as though PUHCA Section 13(b) was a substitute for the reasonableness investigations conducted by the FERC (and state commissions) in the context of rate proceedings. In rejecting a "preemption of the field" analysis regarding regulation of rural electric cooperatives by state authorities, when the FERC had declined to regulate those entities, this Court observed that "Congress' purpose in 1935 [in enacting the FPA provisions regarding regulation of interstate electric utilities] was to fill a regulatory gap, not to perpetuate one." *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 384 (1983) (footnote omitted). By divesting the federal agency entrusted with interstate electric rate regulation of jurisdiction over an important element of the rates of those utilities who belong to interstate holding company systems, the lower court created an outcome even more unreasonable than that rejected by the Court in *Arkansas Electric Cooperative Corp.* Moreover, although the court only purported to consider the wholesale ratemaking jurisdiction of the FERC, its analysis would appear to divest state commissions of jurisdiction over this aspect of retail rates as well.

The Court of Appeals reached this drastic result by means of the following analysis:

1. PUHCA Section 13(b), and the SEC's regulations thereunder, impose requirements on Ohio Power with regard to the price of SOCCO coal.

2. The FERC's market-price test also imposed a requirement on Ohio Power as to that same subject matter, because it resulted in a disallowance of a portion of the price paid by the utility.

3. Under FPA Section 318, the FERC cannot impose such a requirement.

The court's analysis is based on an implausible interpretation of both statutory provisions.

The wording of PUHCA Section 13(b) is strikingly different from Sections 205 and 206 of the FPA, which are the source of the FERC's authority to set just and reasonable rates. *Compare* 15 U.S.C. § 79m *with* 16 U.S.C. §§ 824d and 824e. It is well-established that statutes giving federal or state agencies the power to disallow unjust and unreasonable rates empower them to prohibit flow-through to consumers of excessive, unnecessary or imprudent costs. *Acker v. United States*, 298 U.S. at 430-31. When a utility or other service provider subject to such a statute engages in dealings with unregulated affiliates, a critical element in rate regulation is the scrutiny of such transactions and disallowance of excessive costs resulting from self-dealing. *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 607-08 (1945); *Western Distributing Co. v. Public Service Comm'n of Kansas*, 285 U.S. 119, 124-25 (1932). By contrast, Section 13(b) of PUHCA, on its face, applies only to a supplier of goods or services, such as SOCCO, not to a purchasing utility, such as Ohio Power. Even if the statute is read as applying to Ohio Power as well as to SOCCO, it only addresses one limited aspect of the larger issue with which the FERC was concerned in setting just and reasonable rates. Section 13(b) requires that sales of coal by SOCCO to Ohio Power, *if* they occur, must not be at a price greater than cost. The statute, however, does not address the question of whether and to what extent purchases by Ohio Power at SOCCO's price are reasonable in light of the price of coal available from other sources, including non-affiliated suppliers.

The lower court's claim that it was cognizant of the SEC's lack of ratemaking authority [15] is hollow. In essence, as the court's reliance on *Nantahala Power & Light Co. v. Thornburg, supra*, reveals, it has delegated an important component of ratemaking to the SEC. In *Nantahala*, this Court held that a state retail commission was preempted from regulating the price of wholesale electric power purchases by a retail utility, because that price was subject to a federal *ratemaking* authority: the FERC.[16]

In short, the most reasonable interpretation of the statute is that the FERC's orders are not beyond the scope of its jurisdiction under FPA Section 318, because PUHCA Section 13(b) does not impose any requirement on Ohio Power, at least with regard to the subject matter addressed by the FERC. That subject matter is *not* the price of SOCCO's sales to Ohio Power, but the reasonableness of Ohio Power's fuel costs in light of the options available to the utility.

In the alternative, even if Section 13(b) of PUHCA addresses, or authorizes the SEC to address, the same subject matter that was addressed by the FERC, the latter's orders are in no way inconsistent with the requirements of Section 13(b), the SEC's rules, or the SEC orders regarding the SOCCO-Ohio Power relationship. That FPA Section 318 does not invalidate a FERC order in the absence of a conflict with a specific PUHCA requirement is indicated by this Court's holding in *Northwestern Electric Co. v. FPC*, 321 U.S. at 125. Any other interpretation would be inconsistent with Congress' delegation to both the SEC and the FERC of authority over numerous subject matters regarding public utility holding company systems, including security issuances, asset transfers, and accounting.[17]

The specific SEC orders contain nothing inconsistent with the FERC's use of a market-price test to disallow

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[15] 880 F.2d at 1407 (Pet. Cert. App., p. 11a).

[16] The majority below attempted to draw a distinction between the FERC's regulation of the *price* of an inter-affiliate sale, which is barred by FPA Section 318, and its regulation of the *quantity* purchased given the price, which remains within the FERC's jurisdiction. 880 F.2d at 1409-10 (Pet. Cert. App., pp. 17a-18a). This distinction applies to the scope of permissible state regulation of retail rates when a utility purchases electricity or natural gas at a price subject to FERC ratemaking jurisdiction; it does not reflect the nature of the FERC's and the SEC's regulation of inter-affiliate transactions in registered holding company systems. The FERC applied the market-price test to Ohio Power in order to protect ratepayers from unreasonable purchases of coal from affiliates such as SOCCO when lower-priced alternatives were available. The SEC did not consider that issue at all.

[17] The lower court concluded that Congress had delegated regulation of inter-affiliate transactions solely to the SEC because Section 13(b) requires the SEC to ensure that inter-affiliate sales are "in the public interest [and in the interest of] investors [and] consumers and . . . that such contracts are performed economically and efficiently . . . at cost. . . ." (15 U.S.C. § 79m). 880 F.2d at 1406 (Pet. Cert. App., pp. 10a-11a). However, the SEC and the FERC/FPC jointly administer a number of the policies enumerated in PUHCA. For instance, one of the fundamental policies of PUHCA is to eliminate excessive charges for goods and services, and unreasonable write-ups of asset values, due to self-dealing within holding company systems. PUHCA Section 1(b)(2), 15 U.S.C. § 79a(b)(2). This policy has been administered by both the SEC and the FPC/FERC in their regulation of utility accounts. *Northwestern Electric Co. v. FPC, supra; California Oregon Power Co. v. FPC, supra; American Power & Light Co. v. SEC*, 158 F.2d 771 (1st Cir. 1946), *cert. denied*, 331 U.S. 827 (1947); *Georgia Power Co.*, 31 S.E.C. Docket at 623 & nn. 11-15, and cases there cited.

Another important policy underlying PUHCA is regulation of utility accounting to ensure accurate reporting to investors. Section 1(b)(1), 15 U.S.C. § 79a(b)(1). The enforcement of this policy by the FPC against an AEP operating utility, pursuant to the FPC's general jurisdiction over accounting, was upheld by the Court of Appeals for the Fourth Circuit because there was no actual conflict with any SEC requirement. *Appalachian Power Co. v. FPC*, 328 F.2d 237, 246-52 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964).

a portion of Ohio Power's payments to SOCCO. They merely note that SOCCO's price to Ohio Power would not exceed SOCCO's cost. Those orders at most set a ceiling, but not a floor, on SOCCO's charges and Ohio Power's payments. Even if the FERC's disallowance is conceived as regulating the price of the SOCCO coal, the FERC did not violate the SEC's ceiling. 880 F.2d at 1411-12 (Pet. Cert. App., pp. 21a-23a) (opinion of Mikva, J.).

Nor do the statute or the SEC's rules—17 C.F.R. §§ 250.90-250.92—impose any requirement on SOCCO or Ohio Power inconsistent with the FERC orders. They do not specify when purchases from an affiliate are reasonable, in light of the affiliate's costs and the prices of comparable goods or services available from other sources. To conclude that the intent of Section 13(b) was to establish that any inter-affiliate sale is just and reasonable as long as the price is based on the affiliate seller's cost, regardless of how excessive the costs of the transaction might be compared to the alternatives, would be inconsistent with the provision's requirement that affiliate sales to a utility such as Ohio Power be "performed economically and efficiently for the benefit of [the purchasing utility] at cost . . . ." 15 U.S.C. § 79m(b). It would also be inconsistent with the Congressional concern over self-dealing by holding company systems at the time that the Public Utility Act of 1935 was drafted and with the FPA's prohibition of unreasonable and excessive rates. As for the SEC's rules, they prohibit prices "at *more than* cost" (17 C.F.R. § 250.90 (a)(2), emphasis added), and impose *market-price* limitations on the sale of goods produced by the affiliate seller (§ 250.90(d)(2) and § 250.92(b)).

The Court of Appeals applied the doctrine of "trapped costs," articulated in *Nantahala Power & Light v. Thornburg* and *Mississippi Power & Light v. Moore*, to a federal regulatory ssytem where it has no applicability. Those cases teach that a state is preempted from trapping costs regulated by the FERC under the FPA—the price of wholesale electric power, and power costs allocated among utilities within a holding company system by means of wholesale power agreements—by disallowing them in retail rates. Under the federal regulatory system established by the Public Utility Act of 1935, however, the SEC's role is not analogous to the FERC's role in *Nantahala* and *Mississippi*. The FERC, the North Carolina Utilities Commission and the Mississippi Public Service Commission are ratemaking agencies which operate at different levels of commerce in electricity (interstate or intrastate). The SEC, on the other hand, traditionally has not asserted jurisdiction—and certainly does not possess *exclusive* jurisdiction—to assess the reasonableness of a utility's efforts to provide electric service to wholesale or retail customers at a just and reasonable price. In the Public Utility Act of 1935, Congress delegated jurisdiction over wholesale electric service to the FERC (then the FPC), and left jurisdiction over retail electric service to the states.[18] Unless the FERC (or a state commission) specifically countermands an order or regulation of the SEC, it does not "trap" any costs. Certainly in the case at bar, the FERC's orders did not disallow any costs that Ohio Power could reasonably have expected were immune from

[18] In *Nantahala*, the Court observed that the "filed rate doctrine" establishes the FERC's exclusive jurisdiction over wholesale electric transactions. 476 U.S. at 962-67. Under that doctrine and the FPA, utilities are obligated to file with the FERC tariffs specifying their wholesale rates and services, and all contracts affecting those rates and services, and are bound to adhere to those terms unless modified by the FERC. 16 U.S.C. § 824d(c) and (d); *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). The statute provides for public notice, FERC review of the reasonableness of tariffs and contracts filed, and refund protection from excessive rates. 16 U.S.C. §§ 824d(e) and 824e. Section 13(b) of PUHCA and the SEC's rules do not establish a system of filed tariffs and rate review. 880 F.2d at 1408 (Pet. Cert. App., p. 15a).

ratemaking scrutiny, in light of the history of SEC and FERC regulation.

CONCLUSION

The decision of the lower court should be reversed.

Respectfully submitted,

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